LIBRARY
SUPREME COURT, U. S.

FILED
JUN 19[illegible]
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1968
No. [redacted] 183

A. J. INDUSTRIES, INC.,

Petitioner,

vs.

THE UNITED STATES.

Petition for a Writ of Certiorari to the United States Court of Claims.

CARL A. STUTSMAN, JR.,
JACK R. WHITE,
HILL, FARRER & BURRILL,
445 South Figueroa,
Los Angeles, Calif. 90017,
Attorneys for Petitioner.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

SUBJECT INDEX

	Page
Opinion Below	1
Jurisdiction	1
Questions Presented	2
Statutes and Regulations Involved	3
Statement	3
A. The Essential Facts Establishing the Loss	3
B. The Facts Establishing Petitioner's Claim	5
C. The Decision of the Court of Claims	6
Reasons for Granting the Writ	7
Conclusion	7

INDEX TO APPENDICES

Appendix A. Opinion Findings of Fact and Conclusion of Law of the United States Court of Claims ..... App. p. 1

Appendix B. Pertinent Statutes and Regulations Involved ..... App. p. 64

TABLE OF AUTHORITIES CITED

Cases	Page
Boehm v. Commissioner, 326 U.S. 287	9, 10
Colorado and Utah Coal Co., 26 B.T.A. 588	8
Empire District Electric Co., 4 T.C. 925	8
Harlan v. United States, 312 F. 2d 402	13
Hazeltine Corp. v. United States, 170 F. Supp. 615	8, 11
Hummel v. United States, 227 F. Supp. 30	8
I. Lewis Corp., 22 T.C.M. 35	8, 11
McIlwaine, Emma C., 11 T.C.M. 964	8
Mine Hill & Schuylkill Haven R. R. v. Smith, 184 F. 2d 422	8
Pearl Assurance Co. v. United States, 324 F. 2d 512	13
Portland General Electric Co., 6 T.C.M. 1165	8
S. S. White Dental Mfg. Co. v. United States, 55 F. Supp. 117	8, 10
Talache Mines v. United States, 218 F. 2d 491	8
Tennessee Consolidated Coal Co., 24 B.T.A. 369	8
United States v. Huntington Laboratories, 82 F. 2d 356	8
W. B. Davis & Son, Inc., 5 T.C. 1195	8
Walsh v. United States, 163 F. Supp. 421	8
White Starr Line, 20 B.T.A. 111	8

Regulations

Treasury Regulations 118, Sec. 39.23(e)-3(a)	8
Treasury Regulations, Sec. 1.165-1(d)(4)	9
Treasury Regulations, Sec. 1.165-2	9
Treasury Regulations, Sec. 1.1312-4(b)	12

Statutes Page

Internal Revenue Code, Sec. 165(a) 2, 3, 7, 9, 11, 12

Internal Revenue Code, Sec. 165(g) 10

Internal Revenue Code, Sec. 166 10

Internal Revenue Code, Sec. 1311 ..... 2, 6, 12

Internal Revenue Code, Secs. 1311-1314 3

Internal Revenue Code, Sec. 1312(4) 13

United States Code, Title 28, Sec. 1255(1) 1

United States Code, Title 28, Sec. 1491 6

Textbooks

Mertens, Law of Federal Income Taxation, Sec. 14.08a 13

IN THE

Supreme Court of the United States

October Term, 1967
No. .....

A. J. INDUSTRIES, INC.,

Petitioner,

vs.

THE UNITED STATES.

Petition for a Writ of Certiorari to the United States Court of Claims.

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner, A. J. Industries, Inc., prays that a writ of certiorari issue to review the opinion and judgment of the United States Court of Claims in this case.

Opinion Below.

The Opinion, Findings of Fact and Conclusion of Law of the Court of Claims, reported at 388 F.2d 701, appear in Appendix A to this Petition.

Jurisdiction.

The decision and judgment of the Court of Claims was entered on December 15, 1967. A timely motion for rehearing filed by petitioner was denied by order of the court entered on March 15, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

Questions Presented

Petitioner was denied an income tax deduction under Section 165(a) of the Internal Revenue Code for a loss which it claimed was sustained in 1958 when it abandoned the underground workings of its gold mine in Juneau, Alaska. The Court of Claims held no deduction was allowable on the ground that the mine "became worthless prior to 1958." This raises the following questions:

1. When does a taxpayer sustain a "loss," within the meaning of Section 165(a) of the Internal Revenue Code, with respect to a non-depreciable business asset which the taxpayer abandons because it is no longer useful in his business as the result of a change in business conditions?

(a) What is the proper test for determining when the asset has lost its usefulness in the taxpayer's business, so that he is required to abandon it and/or claim his loss?

(b) Is the loss sustained and deductible only in the year in which the asset first loses its usefulness, regardless of when it is abandoned or whether it is abandoned at all?

(c) Must the taxpayer carry out the abandonment and/or claim his loss as soon as the asset loses its *present usefulness,* even though he believes it has sufficient *potential value* to warrant its retention on the chance that conditions will change to make it useful again?

2. In view of the Court of Claims' own rules regarding liberal construction of refund claims, and the mitigation provisions contained in Sections 1311, *et seq.* of the Internal Revenue Code relating to a deduction incor-

rectly claimed by a taxpayer in one year but allowable in a different year, was the court under a duty to determine whether petitioner's loss was sustained in 1956 or 1957, if not 1958?

Statutes and Regulations Involved.

This case involves the Internal Revenue Code of 1954, Sections 165(a) and 1311-1314, together with the applicable Treasury Regulations. The relevant portions of the Code and Regulations are set forth in Appendix B to this petition.

Statement.

A. The Essential Facts Establishing the Loss.

The following facts are believed essential to an understanding of the questions raised herein. They are not in dispute.

Petitioner (formerly the Alaska Juneau Gold Mining Company) operated a gold mine in Juneau, Alaska, from 1897 until 1944. [F. 3.][1] In 1944, the mine was shut down because wartime conditions and the fixed price of gold made it impossible to operate at a profit. [F. 21-25.] However, petitioner's management and the goldmining industry in general were confident that conditions would improve after the war, and that the price of gold would be increased to make mining profitable again. In the meantime, petitioner's management attempted to preserve its mining assets for future use. [F. 28, 42; Rep. Vol. I, p. 161; Vol. II, p. 4.]

---

[1]The designation "F." refers to the Findings of Fact of the Court of Claims which are set forth in Appendix A to this petition. "Stip." refers to the Stipulation of Facts which was incorporated into the Reporter's Transcript in Volume I, pp. 11-26. "Rep." refers to the Reporter's Transcript which is in three Volumes.

Between 1944 and 1956, conditions grew worse rather than better. Nevertheless, at the start of 1956, a majority of petitioner's management, all of whom had long been connected with the gold mining industry, continued to believe the Juneau mine was a potentially valuable asset which they were obligated to protect for petitioner's stockholders. They still hoped Congress would increase the price of gold. [F. 28, 42, 46.][2]

During 1956, however, a proxy contest resulted in a shift of petitioner's control to the victorious insurgents who campaigned on a program of diversification. [F. 45-47.] After assuming control in June of 1956, new management began to discuss the question of whether they should abandon any further preservation of the mine and write off the substantial investment in mining assets still being carried on the company's books and financial statements. [F. 60-70.] However, they believed they should move cautiously. Among other considerations, petitioner's management feared an immediate write-off of the mining assets might cause a delisting of the company's stock from the New York Stock Exchange to the serious detriment of the stockholders. [F. 71.]

Two independent professional appraisals were ordered by new management; one was received in late 1957 and the other in early 1958. They confirmed the opinion of two mining experts on petitioner's Board of Directors that it was unlikely there would never be a large enough increase in the price of gold to enable the Juneau

---

[2]A chronology of the post-war gold movement in the United States was set out in petitioner's reply brief to the Court of Claims, along with abundant authority to the effect that the court could take judicial notice of these historical occurrences. As shown there, agitation for gold reform occurred repeatedly throughout this period and was still going on as late as 1958.

mine to become profitable again—and if such increase did occur it would be too distant and was not worth waiting for. [F. 61-63, 66-68, 75, 85, 86.]

By October of 1958, petitioner had acquired sufficient assets from corporate acquisitions to remove the risk of a stock exchange delisting if the mining assets were written off. [F. 72, 73, 75.]

In December of 1958, on the recommendation of petitioner's president, the Board of Directors adopted resolutions directing the officers to abandon the investment in the underground workings of the Juneau mine. [F. 75, 76.] Following such resolutions, petitioner's president instructed the general manager at Juneau to stop maintaining the mine, and petitioner's capitalized development costs were written off as of December 31, 1958. [F. 77, 80.]

It was stipulated by the parties that if the court found there was an abandonment of the underground workings of petitioner's Juneau mine in 1958, the amount of the loss realized by petitioner would be measured by the adjusted basis of petitioner's capitalized development costs. [Stip. Para. 21.][3]

B. The Facts Establishing Petitioner's Claim.

Petitioner claimed a deduction in the amount of approximately $2,032,379.85 in its 1958 corporate return, representing the loss sustained on the abandonment of the mine. The deduction created a net operating loss. The disallowance of the deduction by the Commissioner of Internal Revenue and elimination of the net operating loss resulted in deficiencies of tax and interest ag-

[3]The correct amount of the adjusted basis of petitioner's capitalized development costs was also in dispute in the proceedings below. However, the court did not reach this question.

gregating $958,692.93 for the years 1957, 1958 and 1959. [Stip. paras. 5-7.]

Petitioner paid the deficiencies and filed timely claims for refund. Following denial of the claims by the Commissioner of Internal Revenue, petitioner commenced this suit in the United States Court of Claims which had jurisdiction by virtue of 28 U.S.C. 1491. [Stip. paras. 8-9.]

C. The Decision of the Court of Claims.

The case was tried before a Trial Commissioner. The court adopted his recommended Opinion, Findings of Fact and Conclusions of Law without modification except for the deletion of one finding which is not relevant to the issues presented in this petition.

The court held petitioner was not entitled to recover on the ground that its Juneau mine became "worthless" in a year prior to 1958. The prior year in which the loss was sustained was not specified in the decision. However, questions and comments from the court during oral argument, and its findings, indicate that it did not believe the loss occurred for tax purposes prior to the change in petitioner's management in 1956. [Ultimate Findings of Fact 105-110, Appendix A.]

Petitioner moved the court for a rehearing to seek clarification as to the year in which the loss was sustained. Petitioner's brief in support of the motion pointed out that it was of utmost importance that the decision specifically determine whether the loss was sustained in the years 1956 or 1957. If the loss was sustained in either of those years, petitioner is entitled to claim the deduction in the proper year under the express provisions of Sections 1311, *et seq.* of the Internal Revenue Code.

The motion for rehearing was denied.

Reasons for Granting the Writ.

This case raises important questions of tax law which have never been passed upon by this Court. So far as petitioner's research discloses, the United States Supreme Court has never decided a case involving an abandonment loss under Section 165(a) of the 1954 Internal Revenue Code or its predecessors under prior Revenue Acts. Petitioner believes the principles involved are of such significance to taxpayers engaged in business and to the Government in the collection of Internal Revenue taxes that they should be considered and settled by this Court regardless of the merits of the lower court's decision.

Furthermore, the decision of the Court of Claims adopted an interpretation of the law which is inconsistent with a long line of other Federal decisions and flatly contrary to the applicable Treasury Regulations. More important, it is not based upon sound analysis or reasoning and creates a "test" for determining the year of deduction of a loss under Section 165(a) which is unfair, if not unworkable. It will undoubtedly lead to widespread uncertainty and extensive litigation. Ultimately, it will cause many taxpayers to suffer harsh and unjust forfeiture of the right to deduct a loss they actually sustained, as occurred in the instant case.

To begin with, the court made a fundamental error as to the nature of a loss on business assets and when and how it is sustained within the meaning of Section 165(a). The effect of its holding is that the loss is sustained by reason of an asset becoming "worthless" and is deductible only in the year in which it becomes worthless, regardless of when it is abandoned or whether it is abandoned at all. This is contrary to nu-

merous Federal decisions. See, *e.g., United States v. Huntington Laboratories,* 82 F. 2d 356 (7th Cir. 1936); *Mine Hill & Schuylkill Haven R. R. v. Smith,* 184 F. 2d 422 (3rd Cir. 1950); *Talache Mines v. United States,* 218 F. 2d 491 (9th Cir. 1954); *Walsh v. United States,* 163 F. Supp. 421 (D. Neb. 1958); *Hummel v. United States,* 227 F. Supp. 30 (N. D. Cal. 1963); *I. Lewis Corp.,* T. C. Memo 1963-13, 22 T.C.M. 35 (1963); *Emma C. McIlwaine,* 11 T.C.M. 964 (1952); *Portland General Electric Co.,* 6 T.C.M. 1165 (1947); *W. B. Davis & Son, Inc.,* 5 T.C. 1195 (1945); *Empire District Electric Co.,* 4 T.C. 925 (1945); *Colorado and Utah Coal Co.,* 26 B.T.A. 588 (1932); *Tennessee Consolidated Coal Co.,* 24 B.T.A. 369 (1931); *White Starr Line,* 20 B.T.A. 111 (1930).[4]

These cases demonstrate that abandoment is critical—the *sine qua non* which supplies the indentifiable event necessary to fix the loss. The taxpayer must either permanently discard the asset, or discontinue the business in which it is used. The asset's loss of usefulness, based upon the business judgment of the taxpayer, is merely the circumstance which causes him to take the affirmative action; and until he does so, his loss is not fixed and he is not entitled to a deduction.

This principle was made abundantly clear by Treasury Regulation 118, Section 39.23(e)-3(a), which was in effect during the years in question. It expressly states that when an asset is abandoned because it lost

---

[4]Two other contra authorities are the Court of Claims' own decisions in *S. S. White Dental Mfg. Co. v. United States,* 55 F. Supp. 117 (Ct. Cl. 1944) and *Hazeltine Corp. v. United States,* 170 F. Supp. 615 (Ct. Cl. 1959). Although the decision in the instant case is totally inconsistent with the rationale of those decisions, the court did not overrule or disapprove them or explain the inconsistency.

its usefulness in the taxpayer's business, "he may claim [the] loss for the year in which he takes such action."

The Court of Claims incorrectly held that this Regulation was superseded retroactively by Regulation Section 1.165-2, adopted in 1960. The new Regulations expressly gave petitioner the option to use the existing Regulations. Reg. Sec. 1.165-1(d)(4). But even under the new Regulation, the result should be the same. Although Regulation Section 1.165-2 states that the loss is "not necessarily" sustained in the year of *overt* action by the taxpayer, this must be limited to rare situations where the taxpayer covertly abandons the asset in an earlier year but purports to do so again in a later year for the sole purpose of postponing his deduction. To be consistent with the many decisions holding that mere non-use of an asset does not establish a loss, the determination must ultimately turn on the taxpayer's ascertainable intent.

It cannot be disputed from the court's findings that petitioner's management did not intend to abandon the underground workings of its mine until 1958. [See, *e.g.*, F. 42, 46, 71-73, 75.] The test adopted by the Court of Claims ignores the element of intent.

It is apparent from the court's opinion that it regarded losses under Section 165(a) as analogous to losses on worthless securities and worthless debts. It cited this Court's decision in *Boehm v. Commissioner*, 326 U.S. 287 (1945), and other worthless security and debt cases, for the proposition that "worthlessness" in fact is the critical factor and is to be determined by an objective test rather than a subjective one. But those decisions and their rationale are not properly ap-

plicable to abandonment losses. The loss on securities or debts is sustained solely by their becoming worthless under the express language of the respective code sections involved (Sections 165(g) and 166). Moreover, the nature of a loss on worthless debts or securities is quite different from the nature of a loss on assets used in a business. Whereas the *Boehm* rule works no injustice when applied to debts or securities, it is most unfair when applied to business assets.

A debt or security is merely a claim for money or property, a chose in action. When the claim becomes uncollectible (*i.e.*, worthless), which can be determined objectively, its holder immediately sustains a permanent loss of his investment. No action on his part is necessary to establish the loss, nor can he prevent it. It is incurred solely by reason of the claim becoming worthless, which occurs automatically at a given point in time, regardless of the taxpayer's intent, personal judgment, belief or discretion.

By contrast, the events which fix the loss of the taxpayer's investment in business assets are to a great extent within his own control. The question of whether an asset is useful to a particular trade or business or whether a particular business should be discontinued depends largely on the personal business judgment and discretion of the manager of that business.[5] He may recognize that an asset has no present value but feel that it has potential value so that he wants to retain it indefinitely on the possibility that he might be able to use it in the future. So long as he does, he cannot properly be said that he has suffered a permanent

---

[5]See *S. S. White Dental Mfg. Co. v. United States, supra.*

loss of his investment.[6] It should be immaterial whether he happens to be more optimistic about the asset's potential value than other businessmen—it is his business and his assets.

Obviously, opinions of reasonable businessmen may well vary as to whether an unproductive asset should be discarded or retained for possible future use. Since no one can tell except from hindsight which judgment is correct, the tax law should not be construed as permitting the Government to substitute its business judgment for that of the particular taxpayer. Otherwise, taxpayers will be forced to discard business assets which they still believe have potential value, or risk the possible forfeiture of their right to ever claim a deduction for the loss of their investment if history does not vindicate their optimism.

For these reasons, a loss under Section 165(a) should only be deductible when the taxpayer has actually abandoned the asset, unless other identifiable events so establish the taxpayer's intent to treat his investment as irrevocably lost that overt acts of abandonment would be superfluous. The fact that the asset actually loses its value in a year prior to the one in which the taxpayer decides to give it up should be immaterial. Nor should it even matter if the taxpayer has reason to believe he will eventually have to discard it, but puts off doing so because of other bona fide business considerations. So long as it does not appear that his delay in discarding the the asset was clearly unreasonable, he should not lose the benefit of a tax deduction for the loss which he did in fact incur.

---

[6]See *I. Lewis Corp., and Hazeltine Corporation v. United States, supra.*

Finally, even if this Court should conclude that the lower court correctly stated the law in its decision, it is respectfully submitted that the writ should be granted because of what the lower court did not state. The court's reasoning and ultimate findings of fact appear to place the loss in either 1956 or 1957. This would also be consistent with the court's apparent position during oral argument that it did not question the judgment of petitioner's management prior to the change in control which occurred in mid-1956. But the court's failure to fix the precise year of the loss may have serious consequences.

If the loss was in fact sustained in either 1956 or 1957, it was properly deductible at that time under Section 165(a) and should have been allowed by the Commissioner of Internal Revenue in the proper year. Sections 1311, *et seq.* of the Internal Revenue Code expressly give petitioners one year after the court's decision becomes final in which to file new refund claims to obtain the deduction in the right year, if such year was not barred at the time the deduction was claimed in 1958. Hence, both 1956 and 1957 are still open years. (See Reg. Sec. 1.1312-4(b) (Example 1) which is squarely in point.)

Obviously, therefore, it is of vital importance that the correct year of petitioner's loss be determined with precision in this litigation. Otherwise, petitioner will be forced to take its chances based upon what appears to be the court's decision, and will undoubtedly end up litigating most of the very same facts a second time. Under such circumstances, it is submitted the court had a duty to clarify its decision when requested to do so by petitioner on motion for rehearing. Its refusal to com-

ply with such a simple request not only works a serious hardship on this petitioner, but may well frustrate the entire purpose for the mitigation provisions.[7]

Indeed, petitioner believes the court's own decisions in the cases of *Pearl Assurance Co. v. United States,* 324 F. 2d 512 (Ct. Cl. 1963); *Harlan v. United States,* 312 F. 2d 402 (Ct. Cl. 1963) required it to consider the years 1956 and 1957 as alternate years for the deduction based upon the *existing* refund claims. Since the Government's own audit and Statutory Notice of Deficiency (Joint Exhibit 7) actually considered all years prior to 1958, and expressly rejected the loss deduction in any of those years, the present refund claims should be sufficient to raise all years which would be affected by a net operating loss resulting from the loss on the mine.[8]

Conclusion.

For the foregoing reasons, the petition for a writ of certiorari should be granted. A review is necessary to correct a serious misconstruction of federal tax law and to prevent a manifest injustice to this petitioner.

Respectfully submitted,

CARL A. STUTSMAN, JR.,
JACK R. WHITE,
HILL, FARRER & BURRILL,
Attorneys for Petitioner.

---

[7]*Mertens, Law of Federal Income Taxation,* points out in Section 14.08a that the harshness caused by the disallowance of worthless security and debt losses after extensive litigation, by which time the proper year had become barred, was one of the principal factors which moved Congress to add to the Code what is now subdivision 4 of Section 1312.

[8]No refund claim was filed and none is necessary for 1956 and earlier years. Refund Claims are required only for years in which a tax was paid which the taxpayer seeks to have refunded. No tax was paid for 1956 or earlier years.

APPENDIX A.

Opinion Findings of Fact and Conclusion of Law of the United States Court of Claims.

In the United States Court of Claims. No. 114-64 (Decided December 15, 1967)

A. J. Industries, Inc. v. The United States.

Carl A. Stutsman, Jr., attorney of record, and *Jack R. White,* for plaintiff. *Hill, Farrer & Burrill,* of counsel.

Joseph Kovener, with whom was *Assistant Attorney General Mitchell Rogovin,* for defendant. *Philip R. Miller* and *Mitchell Samuelson,* of counsel.

Before Cowen, *Chief Judge,* Laramore, Durfee, Davis, Collins, Skelton, and Nichols, *Judges.*

OPINION

Per Curiam: This case was referred to Trial Commissioner Roald A. Hogenson with diredctions to make findings of fact and recommendation for conclusions of law. The commissioner has done so in an opinion and report filed on March 1, 1967. Plaintiff has filed exceptions to the commissioner's findings and recommended conclusion of law and the case has been submitted to the court on oral argument of counsel and the briefs of the parties. Since the court agrees with the commissioner's findings, opinion, and recommended conclusion of law, with the deletion of one finding, as hereinafter set forth, it hereby adopts the same, as modified, as the basis for its judgment in this case. Plaintiff is, therefore, not entitled to recover and the petition is dismissed.

OPINION OF COMMISSIONER*

Hogenson, *Commissioner:* In this action plaintiff seeks a refund of income taxes and assessed interest in the aggregate amount of $958,692.93 for the calendar years 1957, 1958, and 1959. Plaintiff's claim is founded upon an asserted loss deduction for the abandonment of the underground workings of its Alaska Juneau Gold Mine at Juneau, Alaska, allegedly sustained in 1958, which loss would create a net operating loss for that year, a carryback to 1957, a carryforward to 1959, and to later years not in issue here. The issues between the parties concern not only the amount of the deduction but primarily the allowability of the loss for 1958.[1] Since it is found that plaintiff's gold mine became valueless for tax deduction purposes in a year prior to 1958, the questions pertaining to the amount of the deduction need not be reached as no abandonment claim has been made by plaintiff for prior years. The part of plaintiff's claim herein which pertains to alleged entitlement to a deduction in the taxable year 1957 for an amount reimbursed by plaintiff to a stockholder for proxy fight expenses is no longer in dispute.

Section 165(a) of the Internal Revenue Code of 1954 permits the deduction of "any loss sustained *during the taxable year* and not compensated for by insurance or otherwise." [Emphasis supplied.] 26 U.S.C. § 165-(a) (1952 ed., Supp. V, 1-6-58). The Treasury Regula-

*The opinion, findings of fact, and recommended conclusion of law are submitted under the order of reference and Rule 57(a).

[1]Defendant also contends that section 269 of the Internal Revenue Code of 1954 disallows the claimed deduction for tax avoidance purposes, but since it is concluded that the loss should have been claimed in prior years, it is not necessary to decide this issue.

tions promulgated under the corresponding provision of the 1939 Code (section 23(f)) provide:[2]

> (a) When, through some change in business conditions, the usefulness in the business of some or all of the assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis * * * and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. * * * [Treas. Reg. 118, § 39.23(e)-3-(a).]

The Treasury Regulations (1954 Code) also provide:[3]

> §1.165-2. Obsolescence of nondepreciable property.— (a) *Allowance of deduction.* A loss in-

---

[2]The Regulations under section 165 were adopted on January 16, 1960, and under section 7805(b) of the Internal Revenue Code of 1954 made retroactive to the taxable years beginning after December 31, 1953. 1960-1 Cum. Bull. 93. Treas. Reg. § 1.165-1(d)(4) allows taxpayers the option of applying either the Regulations under the 1939 Code or the 1954 Code to those losses occurring on or before January 16, 1960.

[3]This Regulation is applicable to the tax years here in question since the 1954 Regulations do not specifically provide otherwise. 1960-1 Cum. Bull. 93.

> curred in a business or in a transaction entered into for profit and arising from the sudden termination of the usefulness in such business or transaction of any nondepreciable property, in a case where such business or transaction is discontinued or where such property is permanently discarded from use therein, shall be allowed as a deduction under section 165(a) for the taxable year in which the loss is actually sustained. For this purpose, the taxable year in which the loss is sustained is not necessarily the taxable year in which the overt act of abandonment, or the loss of title to the property occurs. [1960-1 Cum. Bull. 97]

Treas. Reg. § 1.167(a)-8(a)(4) provides a similar rule for the abandonment of depreciable property.

In order for a loss to be deductible under the pertinent statutory section, it must be shown that the loss was actually sustained during the taxable year; that the loss became fixed by an identifiable event in such year; and that there was an intention on the part of the owner to abandon the property. The mere non-use of the property is not enough to constitute an act of abandonment. It is not essential that legal title to the property be lost. Whether the property actually did lose its useful value in a particular year, and whether the owner actually did abandon it as an asset during that year, are questions of fact to be determined from a consideration of all the surrounding facts and circumstances. The issue as to whether the loss was actually sustained calls for a practical, not a legal test, and the standard requires a flexible approach according to the circumstances of each case. The determination as to the year an asset loses its useful value or becomes

worthless is a matter of sound business judgment, and that judgment should be given effect unless it appears from the facts that the decision as to the year of loss was unreasonable or unfair at the time the decision was made. Thus, the test is whether the plaintiff has established that under all the facts and circumstances and in the exercise of reasonable business prudence, it fairly determined that its investment in its mine was lost and should be abandoned as worthless in 1958. *Lucas v. American Code Co.*, 280 U.S. 445 (1930); *Boehm v. Commissioner*, 326 U.S. 287 (1945); *S. S. White Dental Mfg. Co. v. United States*, 102 Ct. Cl. 115, 55 F. Supp. 117 (1944); *Mine Hill & Schuylkill Haven R. R. v. Smith*, 184 F. 2d 422 (3d Cir. 1950), *cert. den.* 340 U.S. 932 (1951); *Rhodes v. Commissioner*, 100 F. 2d 966 (6th Cir. 1939); *Denman v. Brumback*, 58 F. 2d 128 (6th Cir. 1932); *Langdon-Warren Mines, Inc. v. Reynolds*, 52 F. Supp. 512 (D. Minn. 1943); *Stanley Burke*, 32 T.C. 775 (1959) *aff'd* 283 F. 2d 487 (1960); *Diamond Alkali Co.*, 13 T.C.M. 88 (1954); *Empire District Electric Co.*, 4 T.C. 925 (1945); Rev. Rul. 54-581, 1954-2 Cum. Bull. 112; See generally 5 *Mertens Law of Federal Income Taxation*, sections 28.15, 28.17-19 (1963).

The defendant contends that the abandonment loss deduction claimed by plaintiff was properly disallowed for 1958 because (1) the Alaska Juneau Mine became worthless in a year prior to 1958; (2) no overt acts or identifiable event fixed 1958 as the date of the loss, and (3) no asset, tangible or intangible, was abandoned by plaintiff.

Plaintiff contends that it has never abandoned the Juneau Mine as a piece of real estate but that instead

it is seeking to deduct as a loss its investment in the capitalized costs of developing the underground workings of the mine. It claims that so long as it intended to preserve the underground workings of the mine, the capitalized development costs remained potentially valuable and a useful asset until it decided to abandon all hopes of making the mine productive again. Under this theory, plaintiff asserts that the adoption of the corporate resolution directing its officers to abandon the investment in the mine and to write it off its books and financial statements was sufficient to constitute an act of abandonment for tax purposes. Since the resolution of these issues is primarily a question of fact, it is necessary to set out the pertinent facts in detail.

Plaintiff, A. J. Industries, Inc. (formerly known as Alaska Juneau Gold Mining Company), from its incorporation in 1897 until 1944 was engaged in the business of mining gold at Juneau, Alaska, and in California through subsidiaries. From 1897 through 1934 plaintiff acquired various patented mining claims, mill sites, water rights, and electrical power facilities in the vicinity of Juneau, Alaska, and operated these mining properties and facilities as a single mine which was known as the "Alaska Juneau Mine."

The Alaska Juneau Mine contained only low-grade ore, i.e., the gold content per ton of ore was small, so, in order to operate its mine at a profit, it was necessary to mine large quantities of ore at low cost. Plaintiff's method of mining was known as the "induced caving" method which required general development work underground (such as the digging of tunnels and shafts) and development work to prepare specific areas of the mine so that these work areas could be "caved-in" eco-

nomically and safely. Those development costs which benefited the entire mine were identified and carried on plaintiff's books and records as "Mine Development Costs," while those development costs which benefited a specific area of the mine were identified as "Preparatory Mining Costs."

Plaintiff capitalized and amortized the preparatory and mine development costs over the period of time it estimated benefits would be received from the development work to which the costs related. The Internal Revenue Service allowed deductions for amortization of both the Mine Development and Preparatory Mining Costs (plus deductions for cost depletion based upon the March 1, 1913 value of the ore body) through 1931. Thereafter, plaintiff was permitted deductions for amortization of the Preparatory Mining Costs until 1944, when the mine was shut down. After 1931 the deduction for the Mine Development Costs was disallowed by the Internal Revenue Service on the ground that such costs were recoverable only through percentage depletion which in 1931 replaced cost depletion. As of January 1, 1958, the unamortized balance in the Mine Development Account was $1,000,488; the unamortized balance in the Preparatory Mining Account was $1,028,207. It is these unrecovered costs that plaintiff seeks to deduct as a loss for 1958.

In 1934 plaintiff acquired several hydroelectric power plants which supplied the large amount of electrical power needed to operate the mine. These power facilities became an integral part of plaintiff's mining operations. Plaintiff was able to sell excess power to the Alaska Electric Light and Power Company and has continued to sell power to this utility to the present time.

From 1928 until 1942, plaintiff operated the Juneau mine at a net profit and declared and paid dividends over this period of time in excess of $14 million. In 1934 the price of gold was fixed at $35 per ounce, and at that price plaintiff made a profit of approximately $10 per ounce of gold mined or 20 cents per ton of ore produced until 1943. Due to the wartime conditions and the rising costs of supplies and labor, this margin of profit was eliminated so that by 1943 plaintiff incurred net losses in excess of $350,000.

In May 1943, plaintiff's board of directors discussed the deteriorating economic conditions and passed a resolution authorizing the president to shut down the Juneau mining operations, if in his best judgment he considered it advisable. In 1944 the War Labor Board directed plaintiff to grant a 14 cent an hour retroactive pay raise to its employees. This order was the culminating factor in the decision to shut down the mine. Accordingly, plaintiff's president ordered the general manager at Juneau to immediately shut down all operations, except power production, to retain all powerplant operators, all key foremen and those men necessary to perform such maintenance work as necessary to preserve the mine, mill, equipment, and supplies in a standby condition so that mining operations could be resumed after a reasonable length of time. As a result of this order the mine was shut down, and the employee force of between 200 to 300 people was reduced to 44 men, of whom 10 had duties solely with respect to the maintenance of the mine.

At the time of the shutdown plaintiff had a large stock of supplies and replacement parts at the mine. Its retained employees were engaged in various activities

with respect to the mine and mill, consisting of inspection, repairs, cleanup, exploration, and preservation of equipment.

After the shutdown in 1944, the mine was never reopened, and through 1955 plaintiff did not engage in any substantial business or income-producing activity (other than power sales), thereby incurring net operating losses for each of those years.

In 1947 plaintiff began searching for new mining properties. It was approached on the possibility of using the main entrance tunnel (adit) of the mine as a water conduit in a pulp manufacturing venture, the water to be used not only in the manufacturing process but to generate additional electric power. In considering the pulp venture, plaintiff requested its general manager, Mr. Williams, to prepare a report on the condition of the mine and estimated value of the assets and the future prospects of reopening the mine. In his report Mr. Williams assumed that a competent crew could be obtained and based upon the economic conditions as they existed in 1948, he estimated that, based on 1940-41 costs to which 180 percent cost factor had been applied, the price of gold would have to be raised to around $60 per ounce in order to profitably operate the mine. Mr. Williams reported that in general the mine was in good condition; the mill was disorderly in appearance; its mill machinery was in good shape but extensive repairs were needed; the powerplants generally were in good condition; and that in order to fully reopen the mine, a large initial expense was required. The report concluded that in 1948 there was not an appreciable amount of ore remaining in the mine which would yield a profit but that with a "moderate amount

of improvements in conditions for gold mining there is enough gold bearing rock * * * to make the mine profitable once more."

In 1950 an option was granted to a Mr. Gray to negotiate a formal proposal for the use of some of plaintiff's assets in a pulp manufacturing venture, but this venture was never placed into operation.

By 1954 only two of the supervisory key men who had duties solely with respect to the mine were still in plaintiff's employ. By this time, mine maintenance had practically ceased. As the employee force had dwindled through the years, less maintenance was able to be accomplished, the rate of natural deterioration increased, drifts and cave-ins occurred which were not corrected or removed, and only the main entrance tunnel (adit) was kept clear to preserve access to the mine and machinery. Initially the lower levels of the mine were kept dry by pumping out the water which accumulated, but by 1952 long stretches of pipe were rusting out and the pumping equipment was in need of expensive repairs. In order to reduce the pumping costs and avoid the expensive repairs, it was decided that if the lower levels of the mine were flooded and thereafter allowed to fill with water, the cost of replacing the equipment could be avoided. It was also decided that the flooding would help preserve the untreated timbers in the lower part of the mine. Accordingly, the equipment in the lower part of the mine was removed and the lower levels were flooded. Thereafter, the water was allowed to accumulate naturally.

In 1956 a group of shareholders led by Charles J. Ver Halen, Jr., commenced a proxy fight to gain control of plaintiff. In their proxy solicitations the Ver

Halen committee campaigned on the program to face up to the fact that it was impossible to mine ore at Juneau at a profit and that there was no prospect of mining gold at a profit in the foreseeable future. Ver Halen's committee further stated that plaintiff could only become successful by diversification.

The incumbent management in responding to the arguments and contentions of the Ver Halen committee restated their position of preserving the mine and mining plant for immediate resumption of operations when the price of gold was increased, which they believed would eventually occur.

The Ver Halen committee was successful in its proxy solicitations, and elected four men to plaintiff's seven-man board of directors. Upon assuming control, the new management directed Mr. Ver Halen to go to Juneau to inspect the assets of the company. In August or September of 1956, Mr. Ver Halen inspected the Juneau plant and reported back to the board that while he had found that some of the equipment had been preserved, there were tons of machinery, replacement parts, and scrap materials in a deteriorating condition. He recommended that the board embark as soon as possible on their acquisition plans to get something to earn money for the company.

The two mining engineers on the board of directors (Messrs. Bradley and Crockett)[4] expressed their opinion that the mine could not be profitably operated in

[4]Mr. Bradley was a member of plaintiff's board from 1944 to 1959 and had recommended to the board against reopening the mine since 1952. Mr. Crockett became a member of the board in 1956. He repeatedly told the board the mine was non-economic; it could never be made a commercial operation; and it should be abandoned.

1956 or in the foreseeable future and that the operation should be abandoned.

In October 1956 plaintiff purchased all the stock of the Reynolds Manufacturing Co., a Missouri corporation engaged in the business of manufacturing brake drums for trucks and other large motor vehicles and truck trailer tandems. The purchase price was $2,749,747 payable $1,500,000 down and the rest in installments.

When the new management assumed control of plaintiff, they discovered that the company's treasury had been depleted to around $100,000. In order to raise the money to finance the Reynolds acquisition, plaintiff attempted to borrow $50,000 on the company's assets from the banks in Juneau. The banks refused the loan stating that they didn't consider the assets had any value for security purposes. Plaintiff was able to raise approximately $1,100,000 by factoring the Reynold's accounts receivable and Ver Halen agreed to loan plaintiff $200,000. These amounts, with the $100,000 in plaintiff's treasury, were still $100,000 short of the downpayment. In order to raise the remaining $100,000, plaintiff in late 1956 negotiated a contract with the Craine Steel Co., giving Craine an option on the salvage rights of all mining and mill equipment at Juneau. This contract was subsequently assigned to Machinery Center, Inc., a Utah corporation.

On January 28, 1957, plaintiff and Machinery Center entered into a written agreement appointing Machinery Center as plaintiff's exclusive sales agent on a best-efforts basis to remove and sell all of the mining equipment at Juneau with the exception of that used for power production. In this agreement plaintiff stated

that it realized that the resumption of mining in Juneau was not economically feasible within the foreseeable future.

By the time these salvage contracts were made, the mining equipment had not been used for 13 years. Much of the equipment was obsolete and would have had to be replaced should mining operations ever be resumed. However, notwithstanding the obsolescence of the mining equipment, plaintiff decided to sell its unusable equipment to raise funds for its acquisition program rather than continue the prior management's policy of retaining idle assets until they could be used again for mining purposes.

In 1957 plaintiff's auditors recommended that the Juneau assets be appraised because they represented a substantial part of the net worth of the company. In September 1957, plaintiff authorized the employment of the General Appraisal Company to appraise the Juneau assets. In October 1957 the General Appraisal Company submitted its report stating the opinion that the fair market value of the mine, mill, and ore bodies was $50,000 as of October 27, 1957.[5] The equipment in the mine was not included in this appraisal since it was being dismantled and disposed of. The report stated that the patented lands and the improvements covering the mine, mill, and ore bodies were of no present economic value except in a limited market and on long range speculation. The report also examined the possibilities of an increase in the price of gold and projected a possible price of $73 per ounce by

[5]In its annual report to stockholders for the year ending December 31, 1956, the mining propeties and related equipment and supplies were carried at $15,349,842.

1982, which was considered to be below the price necessary to operate the Juneau properties at a profit.

In 1957 plaintiff hired an engineer consultant, Mr. Wilbur H. Hanson, to inspect the mine underground workings and installed equipment, mill machinery and related equipment and powerplant, to identify and relate such property with that shown on the financial statements and to submit a report as to their physical condition. In his report dated January 10, 1958, Hanson stated that the mine was in extremely poor condition, but that all mine and mill motors, generators, and the underground hoist had been protected and could be placed in operation on short notice. He expressed the opinion that gold mining could not be put on a paying basis even if the price of gold were doubled, and under conditions as they then existed, the remaining ore had no value.

In October 1958, plaintiff acquired substantially all of the outstanding stock of the Fletcher Aviation Corporation whose principal business was the manufacture and sale of external fuel tanks for military aircraft. Until January 1961, Fletcher was operated as a subsidiary when it was dissolved and its assets transferred to plaintiff.

The matter of permanently abandoning mining at Juneau was considered by plaintiff's new management at various times after taking office in 1956, but no definitive action was taken.

The major factor plaintiff's new management considered in refusing to abandon the Juneau properties was the fact that plaintiff's stock was traded on the New York Stock Exchange.

Plaintiff's management was concerned that if the mining assets, which accounted for approximately 78 percent of its total asset value,[6] were suddenly removed from its financial statement or were substantially written down, it would lose its stock listing. Thus, one of the principal reasons for the Fletcher acquisition was to strengthen its net asset position.

On December 16, 1958, plaintiff's board of directors adopted a formal resolution directing its officers to abandon as worthless the investment in the Mine Development Costs and Preparatory Mining Costs. As of December 31, 1958, these assets were written off plaintiff's books.

In 1959, plaintiff went through a quasi-reorganization to readjust the value of the remainder of its mining properties as of March 31, 1957, to reflect their then estimated fair market value. This reevaluation was made by reducing the assets on the books by $11,130,936, eliminating the deficit in plaintiff's earned surplus in the amount of $5,475,260 and at the same time reducing its capital surplus in the amount of $16,606,196.

After plaintiff charged off its investment in the Juneau mining properties in 1958, it nevertheless thereafter paid real property taxes thereon. It also applied for and received annual licenses for several years thereafter to engage in lode mining, but only so that it could

---

[6]In the Annual Report for the year ending December 31, 1957, the Juneau mining properties, not including the power facilities or general office equipment were carried at $15,171,351 (excluding reserves for depletion, depreciation, amortization, and obsolescence). The total net assets, including the Reynolds Manufacturing division, were carried at $19,439,290 (excluding reserves for depletion, depreciation, amortization, and obsolescence). Thus, the mining properties accounted for 78.04% of plaintiff's net assets.

sell to the Government the gold dust salvaged during its program of cleanup and dismantling of equipment.

It is still possible that the Juneau mine could be reopened and mined, provided there were a sufficient increase in the price of gold, which some experts feel will eventually occur. However, in order for plaintiff to reopen the Juneau mine, a tremendous initial capital investment would be required. For example, the three mining experts who testified, estimated that by 1958 the price of gold would have to be increased to between $105 and $120 per ounce in order to operate the Juneau mine at a profit. Furthermore, an initial capital investment of from two to three million dollars would be required.

Plaintiff also had two subsidiaries who owned gold mines in California with ore estimated to be three to four times the value of the Juneau ore. Thus, in view of the higher costs in Alaska, and the low-grade ore, an increase in the price of gold would more likely bring about a reactivation of gold mines in California before the Juneau mine was reopened. Therefore, for all practical purposes, the Juneau property was worthless as a mine by 1958, if not before.

Before plaintiff can claim its deduction for the abandoment loss of the Mine Development and Preparatory Mining Costs in 1958, it mustt be shown that the loss was "sustained during the taxable year." This requirement has been emphasized by this court in *Minneapolis, St. Paul & Sault Ste. Marie R.R. v. United States,* 164 Ct. Cl. 226, 239-241 (1964), which involved the determination of what year certain obligations became worthless. This court noted that prior to 1942 the test of worthlessness was a "subjective" rather than

an "objective" test and that a deduction would be allowed in the year in which "there was a bona fide ascertainment by the taxpayer of the worthlessness of a debt irrespective of whether its worthlessness could have been ascertained prior to the year when it was discovered, so long as the taxpayer exercised reasonable judgment." The court stated that the subjective test was rejected by the Supreme Court in *Boehm v. Commissioner,* 326 U.S. 287, 292 (1945), and that a loss to be deductible must have been sustained *in fact* during the taxable year. The court further stated:

> * * * We interpret this as meaning that the taxpayer now not only has the burden of proving that the debt had some intrinsic value at the beginning of the year it allegedly became worthless and that it became worthless in the taxable year in question, but also that the taxpayer must show that throughout the entire life of the debt, the evidence reasonably available on him pointed out that it was possessed of some value and had not become wholly worthless. * * *
>
> It is obvious that there is no precise test for determining worthlessness within the taxable year and neither the statutory enactment, its regulations, nor the decisions attempt such an all-inclusive definition. From the numerous decisions, we are taught that a determination of whether or not a debt becomes worthless in a particular year must be confined to the fact of the particular case. Furthermore, it is often impossible to select a single factor or "identifiable event" which clearly establishes the time at which a debt becomes worthless and thus deductible. More often it is a series

of events which in the aggregate present a picture establishing that the debt in question has become worthless. Such a decision of necessity requires a practical approach, not a legal test. * * * It must be flexible in nature, varying according to the circumstances of each particular case, so that whatever inferences a court might draw from a particular fact in another case are not binding on the examining court, although the same fact may be present. The Tax Court has aptly said that "worthlessness is not determined by an inflexible formula or slide rule calculation, but upon the exercise of sound business judgment." * * * In making such a determination the taxpayer must follow a rule of reason, avoiding alike the Scyllian role of the "incorrigible optimist" and the Charybdian character of the "stygian pessimist." * * * To be deductible, a debt need not be proven worthless beyond all peradventure, since a bare hope that something might be recovered in the future constitutes no sound reason for postponing the time for taking a deduction. * * * The taxpayer is not required to postpone his entitlement to a deduction in the expectancy of uncertain future events nor is he called to wait until some turn of the wheel of fortune may bring the debtor into affluence.

It appears that the taxpayer must strike a middle course between optimism and pessimism and determine debts to be worthless in the exercise of sound business judgment based upon as complete information as is reasonably obtainable. [Citations omitted.]

Plaintiff seeks to distinguish the worthless debt and security cases from the abandonment loss deduction, arguing that there is a distinction between "worthlessness" and "loss of useful value." Plaintiff says that the "worthlessness" of a security or debt can be determined by objective standards while the determination of "loss of usefulness" of an asset to a business must involve some discretion on the part of the managers of the business. Thus, plaintiff says that "so long as the determination [of the loss of usefulness of an asset] is made in the exercise of reasonable business judgment, it must rest entirely with management."

To support its position plaintiff relies primarily upon two cases. In *S. S. White Dental Mfg. Co. v. United States,* 102 Ct. Cl. 115, 55 F. Supp. 117 (1944), the taxpayer operated three manufacturing plants. In 1936 it decided to move one plant to a new location. In May 1937 the operations at the old plant were moved to the new location and the old plant was abandoned. Two months later the old plant was sold and the taxpayer claimed an abandonment loss deduction. The court, with two judges dissenting, considered the sale to be immaterial and in construing the applicable regulations (identical to the 1939 Regulation quoted at the beginning of this opinion) held that "the words 'the usefulness in the business of some or all of the capital assets is * * * terminated' must mean terminated in whole or in such part that, in the opinion of the managers of the business, good management calls for their being discarded." (102 Ct. Cl. at 123)

In *Hazeltine Corp. v. United States,* 145 Ct. Cl. 138, 170 F. Supp. 615 (1959), taxpayer in 1944 wrote off three trademarks as a loss. They had not been used

since 1930 because they pertained to obsolete radio receivers which taxpayer had ceased to manufacture. The deduction was allowed for 1944 because it was found that the taxpayer had the right to retain the trademarks on the possibility that it might be feasible to utilize them again in connection with similar products, that the intent to abandon the trademarks was not formulated until 1944, and the identifiable act of abandonment occurred in that year.

But neither *S. S. White* nor *Hazeltine* is authority for plaintiff's theory that the determination of which taxable year an asset became "worthless" or "loses its useful value" is *solely* within the discretion of the business judgment of management. It has long since been settled that an "abandonment loss is deductible only in the taxable year in which it is sustained," Rev. Rul. 54-581, 1954-2 Cum. Bull. 112, and a taxpayer may not postpone the taking of an abandonment loss deduction, which has actually been sustained, to a year in which the deduction will result in a larger savings of tax. *Superior Coal Co. v. Commissioner,* 2 T.C.M. 984 (1943), *aff'd* 145 F. 2d 597 (7th Cir. 1944), *cert. denied* 324 U.S. 864 (1945).

In *Mine Hill & Schuylkill Haven R.R. v. Smith,* 184 F. 2d 422 (3d Cir. 1950), *cert. denied* 340 U.S. 932 (1951), the taxpayer had leased certain railroad lines to the Reading Company under a 999-year lease. The lease required the Reading Company to maintain the lines in good condition. In 1941 and 1943 the taxpayer and the Reading Company filed applications with the Interstate Commerce Commission for permission to abandon certain of the branch lines which had not been operated or maintained for some 12 years. The

court, affirming the Tax Court's denial of the abandonment loss deduction claimed for the years (1942 and 1943), in which the ICC had granted the applications, found on the facts that the losses (taxpayer's investment in lines less salvage value) had not been sustained in fact during the taxable years (1942 and 1943) but that the lines were actually abandoned in years preceding the ICC action.

Also, in *C-O Two Fire Equipment Co. v. Commissioner,* 219 F. 2d 57 (3d Cir. 1955) the court again emphasized the requirement that the loss must in fact be sustained in the year the deduction is claimed. Taxpayer in January of 1946 began to manufacture an instrument called a "Phonette." By November 1946 the venture had proved to be an absolute failure, yet taxpayer attempted modifications of the "Phonette" which also proved to be unsuccessful. In March 1947, taxpayer ceased all attempts to market the "Phonette" and claimed its loss deduction for 1946 on the theory that its inventory of phonettes had become obsolete in that year. The court found that the loss was actually sustained in 1946 even though the optimistic taxpayer had subsequently made futile attempts to keep the market alive. These futile attempts were destined for failure and the evidence showed that the taxpayer did not realize the futility of his efforts until 1947.

Plaintiff contends that its Juneau mine did not lose its usefulness until 1958 because its investment in the underground workings, i.e., the tunnels, raises, etc., still had a potential value so long as it believed that economic conditions for the gold mining industry would improve. Years before 1958, plaintiff's mining experts believed that there was no reasonable prospect that

plaintiff could ever reopen the mine. The evidence in this case certainly warrants the conclusion that plaintiff was an "incorrigible optimist," if one discounts entirely that the real reason for delay was to obtain tax advantages.

The Juneau mine was shut down in 1944, after two successive years of net operating losses. Plaintiff, believing that after the war the economic conditions would improve, maintained the mine on a standby condition for eventual reopening when economic conditions improved. In 1948, in considering whether to use its Juneau assets for other ventures, it was informed that the price of gold would have to be increased to $60 per ounce in order to mine again. After 1948, the economic conditions for gold mining steadily worsened so that by 1958 gold would have had to be increased to between $105 and $120 per ounce to even consider reopening the mine. After 1948, plaintiff expended substantially less and less funds on maintaining its mine in a standby condition, indicating that its hopes were running out. By 1954 only two of his experienced key men remained in plaintiff's employ; its machinery and equipment were becoming worn and obsolete; the natural deterioration of the mine increased; and drifts and cave-ins occurred which were not corrected because its dwindling personnel could no longer keep up with the increased work. The lower levels of the mine were flooded, not only for preservative measures, but also because the pumping equipment had to be replaced. By 1953, it appeared as though the reopening of the mine was highly unlikely, so plaintiff began looking for new business.

By 1956, plaintiff's stockholders were dissatisfied with the policies of the management and elected a new slate of directors who promised "to face up to the fact that there is no prospect of mining gold at a profit from our present properties in the foreseeable future." After Mr. Ver Halen, the leader of the insurgent group, had returned from his inspection of the Juneau mine, he realized the mine was inoperable, uneconomic, and unlikely to be operated in the foreseeable future. He recommended that the board immediately begin its acquisition program. The two mining engineers on the new board expressed their opinion that the mine was noneconomic. The Juneau banks refused to loan even $50,000 on the mining assets.

As further evidence that the mine had no value as a mine, the General Appraisal Company stated in 1957 that the patented lands, mine improvements, mill and ore bodies were of no present economic value. The 1958 Hanson report in effect added nothing to the evidence already compiled and before the board.

Plaintiff contends that its Juneau mine did not become worthless prior to 1958 because the mining assets, including the capitalized development costs, were carried on its books and financial statements, giving it the appearance of financial strength; and that if it had written off these assets prior to 1958, or prior to the Fletcher acquisition, it would have lost its stock exchange listing. The propriety of plaintiff's accounting methods are not in issue here, and undue weight should not be accorded them in determining whether for tax deduction purposes the Juneau mine became worthless or lost its useful value as a mine in 1958 and not in prior years. However, plaintiff's prolonged overstate-

ment of the value of its assets to meet its stock exchange problem, coupled with the obvious tax advantages which accrued, explain eloquently the delay to 1958 in the write-off of the Juneau mine investments. It cannot be ignored that the resolution of plaintiff's board of directors (upon which plaintiff bases its abandonment) was not passed until December 16, 1958, near the end of the first taxable year in which plaintiff made a net operating profit after 14 successive years of net operating loss.

The facts and circumstances in evidence clearly establish that plaintiff's Juneau mine became worthless prior to 1958, and plaintiff's petition should be dismissed.

Collins, *Judge,* took no part in the decision of this case.

FINDINGS OF FACT

1. In this action for refund of Federal income taxes, plaintiff seeks to recover the aggregate amount of $958,692.93 in assessed income taxes and interest for the taxable years 1957, 1958, and 1959.

2. Plaintiff, A. J. Industries, Inc., is a corporation duly organized and existing under the laws of the State of West Virginia with its principal office and place of business in Los Angeles, California.

3. Plaintiff (formerly known as Alaska Juneau Gold Mining Company) was incorporated on February 17, 1897, for the purpose of conducting gold mining operations in the vicinity of the city of Juneau, Alaska. From its incorporation until 1944, plaintiff was actively engaged in the business of mining gold in Juneau,

Alaska, and during that period also mined gold at various times in California through subsidiaries. In 1944, plaintiff suspended all mining operations and has never resumed them.

4. For the taxable years 1956 through 1961, plaintiff filed its corporate income tax returns with the District Director of Internal Revenue at Los Angeles. In its 1958 income tax return plaintiff claimed an abandonment loss deduction in the amount of $2,032,379.85 for its alleged abandonment of the underground workings of its Juneau Alaska gold mine. Plaintiff claimed a net operating loss carryback to 1957 and a carryforward to 1959, 1960, and 1961 by reason of said abandonment loss deduction.

5. On April 27, 1962, the Internal Revenue Service disallowed the abandonment loss deduction, thereby eliminating the net operating loss and the loss carryback and carry-forward, which resulted in assessed deficiencies of $139,912.87 for 1957, $243,762.55 for 1958, and $437,690.96 for 1959, which were paid by plaintiff, together with accrued interest in the amounts of $34,830.64 for 1957, $46,057.76 for 1958, and $56,438.15 for 1959.

6. Plaintiff duly filed its claims for refund which were denied, and this action was timely commenced. Other adjustments made by the Internal Revenue Service to plaintiff's tax returns for the years in question are not in issue in this action.

7. On May 6, 1897, plaintiff purchased 24 patented mining claims, covering the apex of the Juneau, Alaska, gold belt, in the vicinity of Juneau, Alaska. Subsequently, additional mining claims, mill sites, and wa-

ter rights were secured by purchase and location. This mining property is hereinafter referred to as the Juneau mine.

8. In 1934, plaintiff purchased an operating mine known as the "Perseverance mine" (sometimes called the "Gastineau mine"). The Perseverance mine was east of and contiguous to the Juneau mine. Plaintiff also purchased the Gastineau powerplants and other property at such time. Both the Juneau and Perseverance mines were operated together by plaintiff as one mine and treated as such for tax purposes.

9. Plaintiff extracted ore from its Juneau mine by a "caving" system of mining. This method of mining required general development work underground, such as the construction of haulage tunnels, drainage tunnels, shafts, winzes and raises for ventilation and safety. This system of mining also required development work to prepare specific areas so that they could be caved in economically and safely. In plaintiff's books and Federal income tax returns the general development costs which benefited the entire mine were identified as "Mine Development Costs," and the development costs to prepare a specific area for caving were identified as "Preparatory Mining Costs."

10. In plaintiff's books and Federal income tax returns filed through its taxable year 1931, both Mine Development Costs and Preparatory Mining Costs were capitalized and amortized over the estimated period so that benefits would be received from the development work to which such costs related (i.e. such costs were treated as deferred expenses). Deductions for amortization of both Mine Development Costs and Preparatory Mining Costs were allowed by the Internal Reve-

nue Service during such period, in addition to deductions allowed for cost depletion based upon the March 1, 1913 value of the ore body. From 1923 to 1931, plaintiff did not claim any amortization on the Preparatory Mining Costs account on its tax returns filed for those years.

11. Subsequent to 1931, plaintiff elected to compute its depletion allowance on the basis of percentage depletion made available for the first time by a change in the revenue laws with respect to metal mines. This change replaced the cost depletion claimed by plaintiff through 1931. After the taxable year ending December 31, 1931, amortization of Mine Development Costs was no longer allowed by the Internal Revenue Service, on the ground that the remaining basis in this account was determined by the Internal Revenue Service to be recoverable only through the percentage depletion, deduction which had been elected by plaintiff.

12. Amortization of Preparatory Mining Costs continued to be claimed by plaintiff after 1931 and allowed by the Internal Revenue Service, in addition to percentage depletion, through 1944 when the mine was shut down.

13. From March 1, 1913 through December 31, 1940, the total sum of $1,310,628 was expended by plaintiff as Mine Development Costs and capitalized as such in the company's books and Federal income tax returns. The amortization allowed or allowable on plaintiff's capitalized Mine Development Costs from March 1, 1913 through December 31, 1931, totaled $306,276, based upon the extraction of 39,851,344 tons of ore. As of January 1, 1958, there was an unamortized balance in this account of $1,000,488. The amortization

rate for such Mine Development Costs was based on an estimated reserve of 150 million tons of ore as of March 1, 1913.

14. From March 1, 1913, through the taxable year ended December 31, 1944, the total sum of $4,647,272 was expended as Preparatory Mining Costs by plaintiff and capitalized as such in the company's books and Federal income tax returns.

15. The amortization allowable and allowed on plaintiff's capitalized Preparatory Mining Costs from March 1, 1913 through December 31, 1944, totaled $3,619,245, based upon the extraction of 87,793,534 tons of ore. The amortization rates for such Preparatory Mining Costs were based on the ore reserve estimated in the particular areas benefited by the development work. No further amortization of Preparatory Mining Costs was allowable and none was deducted after the year ended December 31, 1944, leaving an unamortized balance of $1,028,027.

16. As of January 1, 1958, the adjusted basis (before reduction for depletion) of plaintiff's mining property, including the Perseverance Mine, was as follows:

March 1, 1913 value	$6,472,287
Additions 1913 to 1926	75,780
Additions 1934 to 1942	844,030
Total Basis for ore body	7,392,097

17. The total depletion allowed or allowable for the years 1913 to 1944 was $8,261,990.

18. Prior to 1928, plaintiff had only one steamplant from which it could obtain the electric power it needed to operate the mine. In 1928 and in 1934, plain-

tiff acquired several hydroelectric plants and a large dam. Plaintiff was expanding its operations and was in great need of cheap power, particularly in the winter time. The power plant operations became an integral and necessary part of the mining operations. In 1934, plaintiff also began to supply excess hydroelectric power from its generating facilities to the Alaska Electric Light and Power Co., which in turn supplied consumers in the city of Juneau. The sale of hydroelectric power to such utility has continued to the present time.

19. The price for which gold can be sold in the United States was fixed by law at $35 per ounce in 1934 and has not been changed. Plaintiff, as a domestic miner of gold, was required by law to sell all of the gold it produced to the United States at that price.

20. The ore which could be produced from plaintiff's Alaska mine was of extremely low grade, i.e., the amount of gold in each ton of ore was small. For the most part, the available gold content of the ore was worth only $1.15 to $1.20 per ton, based upon the fixed price of $35 per ounce. The induced caving method used by plaintiff was one of the least expensive methods of operating a mine, but it was necessary to mine large quantities of ore in order to make a profit. At its most profitable period of operation, in the late 1930's and early 1940's, plaintiff's cost of operation was approximately $25 per ounce, leaving a profit margin of approximately $10 per ounce of gold mined, or $.20 per ton of ore produced.

21. Starting in 1941, the wartime conditions created a shortage of available manpower and made needed supplies scarce and expensive. Plaintiff began los-

ing its employees to other businesses which could afford to pay higher wages, and in order to compete, the company was required to raise its wages. Consequently, plaintiff's general mining costs increased and the tonnage of ore mined decreased until it became uneconomical to operate with the fixed price of gold.

22. The last year plaintiff operated its Juneau gold mine at a profit was in 1942. In 1943 plaintiff incurred a net loss before deduction for depletion in excess of $100,000 and a net loss in 1944 before depletion in excess of $250,000.

23. At plaintiff's board of directors meeting held May 6, 1943, the deteriorating economic conditions for operation of the Juneau mine were discussed. In recognition of the losses suffered during the year, plaintiff's president, Philip R. Bradley, Sr., asked for authority to shut down operations at the mine, when, in his judgment, conditions warranted such action. Consequently, the board passed the following resolution:

> WHEREAS, the economic situation created by the war has resulted in the advance of cost of materials, in difficulty and delay in obtaining such essential supplies as are still available, in shortage of manpower, so that ore tonnage output has been decreased to such a point and cost of its production correspondingly increased, until the margin of profit has been so narrowed that the company's operations are now being carried on close to the border line between profit and loss, and
>
> WHEREAS, it is, in the opinion of the Board of Directors, a short sighted policy and destructive of the best interests of the company under such con-

ditions to unnecessarily use up its ore reserves and its available cash resources, which should be conserved to be utilized and made available during a period when a distinct profit will result from resumed operations, and

WHEREAS, conditions are liable to become more serious instead of improving:

NOW, THEREFORE, BE IT RESOLVED, that the President of this company be and he is hereby authorized and empowered to use his best judgment, in the light of all these surrounding circumstances, and determine whether and when in the best interests of the company and its stockholders and all concerned, it shall be advisable to shut down and cease active operations, and if he shall decide that a shutdown is advisable to take any and all action necessary and advisable to bring about such shutdown for the time being, and to provide for a maintenance crew and such employees in the administrative staff as he may deem essential at such salaries as he may determine to be just under all the circumstances, and take such other steps as may to him seem appropriate to preserve and protect said property and the assets of the company during such period of shutdown.

24. In May of 1944 the War Labor Board ordered plaintiff to pay a 14 cent an hour retroactive pay raise to its employees. Since plaintiff was already losing money due to increased costs of supplies and labor, plaintiff's president, Philip R. Bradley, Sr., pursuant to the resolution of the board in 1943, instructed the general manager, Joseph A. Williams, by telegram, to immediately shut down operations at the mine.

25. When plaintiff's general manager was ordered to shut down the Alaska mine, he was instructed by plaintiff's president to retain all powerplant operators and continue power production to the extent necessary to serve the utility which was serving the city of Juneau and to maintain the mine and its equipment in a standby condition so that operations could be resumed after a reasonable length of time.

26. Pursuant to the instructions the mine was closed down and the employee force of between 200 and 300 people was reduced to 44 men, consisting of watchmen, powerplant operators, linemen, and 25 to 30 keymen. The keymen were shift bosses, mine crew foremen and other heads of departments, who were considered to be essential to the reopening of the mine. Of these 44, only 10 had duties solely with respect to the mine, whose duties after the shutdown related to inspection and maintenance work. Due to deaths and resignations, plaintiff by 1954 had only about two men employed solely with respect to mine maintenance duties at the Juneau mine. By this time, mine maintenance had practically ceased.

27. At the time of the shutdown, plaintiff had a large stock of miscellaneous supplies on hand at or near the mine. Plaintiff also had numerous repair parts for its equipment. Electric heaters were placed in various places in an effort to keep the supplies and equipment dry.

28. In 1944, plaintiff's directors, all of whom were either mining men or had a history of interest in, or a connection with the mining business, were optimistic that the mine could be reopened after World War II.

29. In 1947, plaintiff's management was approached as to the possibility of using the Juneau assets in a pulp manufacturing venture. This, in the estimation of the board, required that they take a look at the gold situation and the general situation at Juneau. Accordingly, a special committee of directors was appointed and plaintiff's general manager Joseph A. Williams, was requested to make a report on the condition of the mine and the estimated value of plaintiff's assets, including its ore reserves, with regard to the future operation of the mine.

30. Pursuant to the board's request, Williams prepared a written report which was received by the board in May 1948.

31. To prepare such a report, Williams assembled engineering records and data kept regularly and brought up to date after the mine ceased to operate. He also referred to various cost records and records of tonnage mined during the period of plaintiff's operation, and he relied on his own knowledge and experience and that of his chief assistant, E. G. Nelson. Both Williams and Nelson were mining engineers who had worked at plaintiff's Alaska mine for many years. The data used by Williams, and the estimates he made in his report from such data, were the best figures available.

32. Williams' 1948 report to plaintiff's board reported that the crew at that time consisted of 33 men, divided as follows: 4 night watchmen, 17 power department men and 12 in the categories of superintendence, office, mine pumping, mill cleanup and shop personnel. The report stated that two hydroelectric power-

plants and the central plant were fully manned, and two others were kept in readiness to operate at comparatively short notice, but that the line crew was undermanned; three mine foremen took care of hoisting and pumping out the deep part of the mine; one carpenter boss patrolled the surface and made minor repairs; one master mechanic was kept busy on inspection and maintenance of the machines in use; a wharfinger was in charge of the stockroom and waterfront; and a four-man crew worked in and around the mill to clean up, make miscellaneous repairs, and keep snow off the roof.

33. The Williams report also stated that in general the mine was then in good condition; that most of the mill machinery was in good shape, though a considerable portion of the equipment was in need of repairs; that the organization of foremen, considered an important intangible asset, had suffered losses since the shutdown, but possibly might still have considerable value; that the power system was in fair working order; that various components of the mine, mill and power system would need repairs and rehabilitation if normal operations were to resume; and that the net income from power sales and gold cleanup at the mill was more than sufficient to offset the cost of maintenance of the mine and plant.

34. The Williams report estimated that at the end of 1943 plaintiff's Juneau mine had a reserve of approximately 28,903,000 tons of ore, containing 894,000 recoverable ounces of gold. The ore was estimated to range from $1.15 to $2.10 per ton in value, with most of it being less than $1.20 per ton. Based on 1941 conditions, with the price of gold at $35 per ounce,

it was estimated this gold could yield a future operating profit of approximately $9,898,000. However, under conditions as they existed in 1948 (assuming a crew was obtainable), it was estimated that the price of gold would have to be about $60 per ounce in order to make a satisfactory operating profit. Such estimate was based upon the 1940-41 operating cost of $.70 per ton to which a 180 percent cost factor had been applied.

35. The Williams report concluded, with respect to the feasibility of future operation of the mine, that while there was no appreciable amount of ore remaining in 1948 which would yield a profit, with a moderate amount of improvement in conditions for gold mining, there was enough gold bearing rock to make the mine profitable once more. It was further concluded that it would require a large initial expense to open the mine on a large scale to resume production at the same high tonnage rate which the mine formerly produced. Accordingly, a more conservative plan, with lower tonnage production, appeared to be more feasible.

36. The use of plaintiff's Juneau assets for the manufacture of pulp was given serious consideration by the board of directors and discussed for a number of years. In 1950 the board granted an option to a Mr. Gray to negotiate a formal proposal covering some of plaintiff's assets for use in a pulp venture, which was later extended, but the venture was never put into operation. One of the concerns of plaintiff's board of directors was how to embrace the pulp venture and still preserve the mine. In this connection, the main problem was whether adequate electric power could be provided for both operations. The proposal was advanced

that additional hydroelectric power be generated by bringing water from high catch basins in the mountains down through the main tunnel of the mine, with the water itself to be used in the pulp manufacturing. The use of the main tunnel as a water conduit was the subject of argument among the directors as to whether the mine could be operated thereafter under such circumstances.

37. By 1947 plaintiff's management started searching for new mining properties, and by 1953 they were actively looking for nonmining business properties. In 1955 plaintiff's charter was amended to permit it to engage in business other than mining.

38. For several years after the mine was shut down, the maintenance crew manned pumps to pump out water which accumulated in the deep part of the mine. The water accumulated slowly and from time to time was pumped up from level to level. After 7 or 8 years, long stretches of pipe used in pumping began to rust out. An idea originated with Williams and the mine foremen that they might stop the pumping and introduce water into the bottom part of the mine in order to reduce the cost of pumping and replacing pump lines. It was also their opinion that covering the untreated timbers in the deep part of the mine with water would help preserve them. The suggestion was discussed with Philip Bradley, Jr., a mining engineer and member of the board since 1944, and in 1952, Williams was instructed by Philip Bradley, Jr., and C. A. Norris, who was then president of plaintiff, to proceed with the flooding. Williams then brought up some of the equipment from the lower levels and flooded the mine from the bottom level, number 13,

up to the number 10 level. Subsequently, water was allowed to gradually accumulate by itself.

39. The conditions, both in the mine and economically, which were considered by Mr. Williams in 1948 in determining that the mine could not operate at a profit, became worse as time progressed. Thus, it is the considered opinion of all the experts who testified that plaintiff's Juneau mine was inoperable as early as 1952. Each of the mining experts (Messrs. Williams, Bradley, Jr., and Crockett) would have recommended against reopening the mine anytime after 1948.

40. During the period from 1944 through 1955, the general manager (Williams) made monthly and annual reports to plaintiff's board of directors in San Francisco concerning the status of the shutdown and standby operation at Juneau. In 1947 the general manager referred to the "standby operation" in Juneau, while by 1953, he referred to the "shutdown operation" of plaintiff.

41. From 1944 through 1955, plaintiff did not engage in any substantial business or income producing activity (other than power sales) and suffered a net operating loss in each of those years. Plaintiff's tax returns filed for the years 1956 and 1957 reported that no Federal income tax was due. The income for 1956 was eliminated by a carryforward of net operating losses incurred in prior years; and in 1957, plaintiff incurred a net operating loss.

For the years 1943 through 1954, these losses, for the Juneau mine alone, totaled in excess of $2,450,000. Its subsidiary, Pacific Mining, incurred an additional net operating loss during the same 12-year period in

excess of $1,500,000. For the year 1955, the Juneau operations experienced a net operating loss in excess of $100,000; and its subsidiary likewise incurred a loss in excess of $130,000.

42. A majority of plaintiff's board of directors from 1944 through the early part of 1956 believed that the price of gold was likely to be increased, and that mining could eventually be resumed at the Juneau mine. It was their policy throughout that period that the Juneau assets should be preserved intact, as far as possible, for a further resumption of operations when conditions improved. Each year after 1944, as the labor force available became smaller, less maintenance was accomplished and the natural deterioration of the mine increased.

43. In 1955, a man named William Norins approached Charles J. Ver Halen, Jr., with the suggestion that plaintiff would be a good vehicle to use as a holding company in the acquisition of industrial firms because (1) plaintiff was a widely held corporation with its stock listed on the New York Stock Exchange, (2) the company had been losing money for 13 years but apparently (based on its financial statements) had substantial assets and (3) it had recently just amended its articles of incorporation to permit the company to engage in businesses other than mining. At that time, following the Korean War, it was common practice to utilize the accumulated losses of one corporation to offset the current profits earned by other corporations.

44. After analyzing several of plaintiff's annual reports, Ver Halen began to purchase plaintiff's stock for the purpose of gaining control of plaintiff. By April or May of 1956, he was the largest stockholder

with between 16,000 and 20,000 shares. This represented about 1½ percent of plaintiff's outstanding stock. Plaintiff then had approximately 7,500 stockholders who were widely distributed.

45. In about May of 1956 Ver Halen organized a Stockholders Action Committee and commenced a proxy fight to gain control of plaintiff. The Committee presented to the stockholders a program for new management to be based on diversification of the company into industrial areas. Its proxy soliciation materials pointed to the fact that plaintiff had suffered 12 years of losses through 1954 because it had failed to engage in any income producing activity except power sales, and stated the Committee's program as follows:

> April 9th, 1944, the mine was shut down because with the price of gold pegged at $35.00 per ounce our directors said it was impossible to mine ore at a profit on our property. The only major source of revenue since 1947 has been a power station which the company bought in the 1930's at Juneau, Alaska.
>
> * * * * *
>
> We believe we can reverse the downward trend and show an improvement for all stockholders if we diversify the business. We propose to face up squarely to the fact that there is no prospect of mining gold at a profit from our present properties in the foreseeable future.
>
> Acquisition of new properties and refinancing, in our opinion, make it possible for Alaska-Juneau to go into profitable enterprises.

46. In response to the arguments and contentions of the Stockholders Action Committee, incumbent management's proxy materials included a letter from plaintiff's president, C. A. Norris, to the stockholders, dated May 10, 1956, which contained the following statement reflecting the policy of the incumbent management:

BACKGROUND OF YOUR COMPANY

The major asset of your Company is the gold mine at Juneau, Alaska, from which we were extracting some 4,200,000 tons of ore annually during the pre-War years, together with a mill with a daily capacity of approximately 14,000 tons of ore. In addition, the Company owns extensive mining equipment and a power system at Juneau which now sells electricity commercially.

During the 15 years of full-scale operation of this mine preceding our entry into World War II, operations were highly successful, and liberal dividends totaling in the aggregate over $14 million were distributed to stockholders in the 12 years ending 1941, after paying off loans of $5 million incurred in developing the mine. The mine was shut down in 1944 because of rising costs brought on by the War. The costs of mining have risen continuously and substantially ever since, while the price of gold remains fixed by government decree at its pre-War level. This has produced a state of depression for the whole gold-mining industry and has had a particularly adverse effect upon our operations, since we depend upon large volume at a low margin of profit.

While it has been evident since the War that the mine could be operated only at a loss under the prevailing economy, nevertheless there has always been some degree of hope for an upward revision of the price of gold. With this possibility ever present, and taking into account the high cost of replacing the mining plant, your Management tenaciously has preserved the mine and mining plant for almost immediately resumption of operations, in the event of the end of the depression for gold.

We cannot forecast when this will occur but through all of the recorded civilization gold has remained one of our most cherished and sought-after commodities. We are confident that eventually gold will come into its own again.

In the meantime the mine at Juneau represents an asset of little immediate but great potential value. This asset has been preserved intact for the stockholders.

* * * * *

During the years since the mine was closed down dozens of other ventures have been considered to produce new sources of income. Most of these could not be acquired on terms regarded as advantageous to Alaska Juneau or were beyond the ability of your Company, with its limited capital, to finance. Our experience along these lines has convinced us that only by substantially increasing the authorized share capital can your Company be put in a position to bargain seriously for desirable new acquisitions.

47. The Stockholders Action Committee was successful in obtaining a sufficient number of proxies

to be able to elect a majority of plaintiff's board of directors. On June 5, 1956, the Stockholders Action Committee elected four of the seven directors to serve on plaintiff's board. They included Charles J. Ver Halen, Jr., Doyle D. McDonald, Edward J. Sargent and Robert C. Hill. Five of the seven men who assumed control of plaintiff in 1956 were members of the Ver Halen group. Only Messrs. Bradley, Jr., and Faulkner represented the old management.

48. On June 5, 1956, plaintiff's board of directors elected the following officers of the corporation:

Charles J. Ver Halen, Jr., President
Doyle D. McDonald, 1st Vice President
Edward J. Sargent, 2d Vice president
Robert C. Hill, Treasurer
J. J. Brandlin, Secretary

The officers who assumed control of plaintiff as of 1956 were all members of the Ver Halen group, with the exception of Mr. Faulkner, the company's Alaska counsel.

49. Mr. Ver Halen, the organizer of the insurgent group, prior to 1956, had wide experience in various types of business ventures other than mining. He had engaged in the business of publishing, manufacturing, motion picture producing and photography. Similarly, the other members of the Ver Halen group had an extensive business background in businesses other than mining. Mr. Will was a stockbroker; Mr. Malone a banker; Mr. McDonald was engaged in the printing and publishing business; and Mr. Sargent an officer in an oil tool and aircraft equipment firm. Of the group, only Mr. Crockett was familiar with mines and

mining operations, as he was a graduate engineer and an independent licensed consulting mining engineer.

50. As soon as Ver Halen's group of directors assumed control of plaintiff, they moved the company's principal offices from San Francisco to Los Angeles and began to analyze the company's financial position. The accounting firm of Arthur Anderson & Co. was engaged as auditors for plaintiff, and Ver Halen asked them to take control of plaintiff's books, analyze them, and give management a report as to plaintiff's condition.

51. After early meetings, the new board of directors instructed Ver Halen to go to Juneau and look at the main assets of the company. In August or September of 1956 he did so. He inspected the assets and was dismayed to find that while some of the equipment had been preserved, there were tons of machinery, replacement parts and scrap materials that were deteriorating.

52. Ver Halen returned to Los Angeles and reported what he had seen to the board. He stated that they would have to embark on their acquisition plan as soon as possible to get something to earn money for the company.

53. In late 1956, plaintiff employed a man named Richmond as Acquisition Vice President. His duties were to investigate and "qualify" industrial firms that were for sale.

54. Through Richmond, plaintiff found Reynolds Manufacturing Company, a Missouri corporation, which was for sale and had attractive earnings. Its business was manufacturing heavy duty brake drums for trucks and other large motor vehicles, and truck and

trailer tandems. In October 1956, plaintiff purchased all of the stock of Reynolds for a total purchase price of $2,749,747, payable $1,500,000 on the date of purchase and the balance in installments. In 1956, following the purchase, plaintiff liquidated Reynolds, acquired its assets and has since continued to carry on its business as the Reynolds Division of plaintiff.

55. After plaintiff acquired Reynolds, plaintiff immediately began to make an operating profit.

56. When Ver Halen's group took over management of plaintiff, they found the funds had been depleted so that there was only something over $100,000 left in the treasury. To raise additional money for the Reynolds down payment, plaintiff attempted to borrow $50,000 from the Juneau banks on its Juneau assets, but the banks refused the requested loan, stating they didn't consider the assets as having any value for security purposes. Plaintiff was able to meet approximately $1,100,000 of the required cash payments by factoring the Reynolds accounts receivable, and Ver Halen loaned plaintiff another $200,000. However, this, together with the $100,000 plaintiff had in its treasury, was still $100,000 short of the $1,500,000 purchase price.

57. To raise the remaining $100,000 needed to acquire Reynolds, plaintiff, in late 1956, entered into an agreement with Caine Steel Co., of Los Angeles, giving Caine an option on the slavage rights to plaintiff's mine equipment, replacement parts and scrap materials. In return for this option, plaintiff received $100,000 in cash which was used to complete the down payment for the Reynolds acquisition.

58. In late 1956 or early 1957, Caine Steel Co. assigned its option on plaintiff's salvage rights to Ma-

chinery Center, Inc., a Utah corporation. Subsequently, on January 28, 1957, plaintiff and Machinery Center entered into a written agreement appointing Machinery Center as plaintiff's "exclusive sales agent on a "best efforts" basis to dismantle, salvage and sell the Juneau mining and mill equipment. Only the powerplant, dams, powerlines, and other equipment used in its power operation were excepted from this contract. In this agreement plaintiff stated that it realized that the resumption of mining in Juneau was not economically feasible within the foreseeable future. The agreement provided for an advance of $200,000 to plaintiff on its share of the anticipated proceeds from the salvage operation. The $100,000 already received by plaintiff in 1956 from Caine Steel Co. was credited against such advance. Plaintiff's purpose in selling the machinery was to raise funds for the acquisition of the Reynolds Manufacturing Company. This agreement was terminated in 1959. Plaintiff entered into negotiations for a new contract to accomplish the sale of the machinery and equipment.

59. At the time the Caine Steel and the Machinery Center agreements were made, plaintiff's management was of the opinion that plaintiff would not be able to mine gold at Juneau profitably in the foreseeable future. The mining equipment had not been used since 1944 and much of it was obsolete and would have to be replaced if operations were ever resumed. In view of these facts, plaintiff's management concluded that it should sell the unusable equipment and inventories to get badly needed cash for plaintiff's acquisition program, rather than continue prior management's policy of retaining idle assets until they could be used again for mining purposes.

60. In early 1957, after the Reynolds acquisition, plaintiff's management took steps to survey the assets and determine what to do with them. There were numerous discussions concerning whether the mine should be abandoned. Both Philip Bradley, Jr. and Robert Crockett, who were the only mining engineers on the new board at that tme, recommended that the mine be abandoned as worthless since it was their opinion that the mine was inoperable as early as 1952, and that the prospect of a sufficient increase in the price of gold to permit a profitable operation at Juneau was so remote as not to be worth waiting for. Ver Halen was also of the opinion after his trip to Alaska in 1956 that the Juneau property could not function economically as a mine.

61. At a meeting of plaintiff's board of directors on April 9, 1957, the company's auditors, Arthur Anderson & Co., recommended that an appraisal be made of the Juneau properties since they represented a substantial part of the net worth of the company as reflected on its books. A resolution authorizing the president to arrange for an appraisal was authorized.

62. On September 10, 1957, plaintiff's board of directors adopted a resolution authorizing plaintiff's president to employ General Appraisal Company to make an appraisal of plaintiff's assets at Juneau.

63. In October of 1957, General Appraisal Company appraised plaintiff's Juneau assets and delivered to plaintiff a written report, dated October 22, 1957, setting forth its opinion as to the fair market value of the mining properties at that time. Plaintiff's patented lands containing the mine, mill, and ore bodies at Juneau were appraised at $50,000. The report also ex-

amined the possibility of an increase in the price of gold and projected a possible price of $73 per ounce by 1982. This was stated to be below the price necessary to operate the properties at a profit. The underground equipment not related to the electrical system was not included in the appraisal since such equipment was being dismantled and disposed of.

64. In plaintiff's annual report to stockholders for the year ended December 31, 1956 (published after April 9, 1957), Ver Halen, as the new president, repeated the pledge which his Stockholders Action Committee had made during the proxy fight to face up to the fact that there were no prospects of mining gold at a profit in the foreseeable future from the properties plaintiff then held, and to reverse the downward trend by diversification. In the Notes to Financial Statements and Auditor's Report sections of the annual report, it was noted that a substantial portion of the company's assets ($15,349,842) was represented by the Juneau assets, including the mine property, related equipment and supplies, development and preparatory mining costs and capitalized losses from 1913 to 1919. It was further noted that the board had authorized the officers of the company to arrange, as soon as practicable, for determinations of the feasibility of future possible economic operations and appraisals of the fair value of such properties. It was also reported that the company had appointed an exclusive agent for the disposition of unusable mining and milling machinery, equipment, and supplies at the Juneau mine.

65. In August 1957 plaintiff's management considered selling the company's powerplant and facilities at Juneau to the Alaska Electric Light & Power Com-

pany, and passed a resolution authorizing Mr. Gray to solicit an offer for the sale of these assets.

66. In 1957 plaintiff also hired an engineer consultant, Mr. Wilbur W. Hanson, to inspect the mine underground workings and installed equipment, mill machinery and related equipment and powerplant, to identify and relate such property with that shown on plaintiff's financial statements and to submit a written report as to their physical condition. Mr. Hanson was familiar with plaintiff's property and general method of operation since he had audited the company's tax return in the 1930's as an engineer revenue agent.

67. In his report dated January 10, 1958, Hanson reported that the mine was in extremely poor physical condition, but that all mine and mill motors, generators and the underground hoist had been protected and could be placed in operation on short notice. Hanson expressed the opinion that gold mining could not be put on a paying basis if the price of gold were doubled, and under conditions as they then existed the remaining ore had no value.

68. Copies of the Hanson report were distributed to the directors, and the board on January 14, 1958, discussed the report in a preliminary manner but tabled the matter.

69. At a meeting of plaintiff's board of directors on April 15, 1958, following a suggestion by the company's auditors, a discussion was had as to the advisability of a

"quasi-reorganization" of the company. Ver Halen expressed the view that a sufficient amount of time had not been spent in the analysis of the preliminary evaluation that had been prepared by the appraisers employed by the company. The board was of the view that the reevaluation of assets and quasi-reorganization of the company should be completed at as early a date as practicable, and adopted a resolution to that effect.

70. Plaintiff's annual report to stockholders for the year ended December 31, 1957 (published after April 22, 1958), again contained a note to the financial statements indicating that a substantial portion of the assets of the company was represented by Juneau mining properties, related equipment and supplies, with a stated value of $15,171,351. Plaintiff's total net assets, including Reynolds Manufacturing, were valued at $19,439,290 (after reserves for depletion, amortization and obsolescence). It was reported that during 1957 the officers of the company had arranged for determinations of the feasibility of future possible economic operations and appraisals of the fair values of such properties; that reports had been received but not reviewed nor approved by the board of directors and therefore were considered to be tentative; but, based upon such tentative reports, the amounts at which such assets were carried appeared to be very substantially in excess of their fair value.

71. The matter of abandoning the mining operations at Juneau was considered by plaintiff's new manage-

ment at various times after they acquired office in 1956, but no definitive action was taken until 1958. Plaintiff's new management was concerned with the possible effect an abandonment of the mining investment and reevaluation of the Juneau assets would have upon its stock. Several members of plaintiff's board of directors were of the opinion that since the mining assets accounted for such a large portion of plaintiff's total assets value (78.04 percent in 1957), a sudden removal of these assets from the financial statement could result in the loss of plaintiff's listing on the New York Stock Exchange. It was their opinion that the loss of the listing on the New York Stock Exchange would destroy the equities of the stockholders. Thus they felt that they had to move cautiously to avoid losing the listing.

72. In October 1958, plaintiff acquired approximately 94 percent of the outstanding stock of Fletcher Aviation Corporation (and subsequently acquired the remaining 6 percent) through an exchange of plaintiff's own shares with the Fletcher stockholders for a total consideration consisting of 679,032 shares of plaintiff's common stock and $4,200 in cash. Upon plaintiff's request the Internal Revenue Service ruled that this transaction, made with the intention to liquidate Fletcher as soon as possible, was a reorganization pursuant to § 368(a)(1)(C) of the Internal Revenue Code of 1954. Fletcher was operated as a subsidiary of plaintiff until January 1961, when it was dissolved and the business and assets transferred to plaintiff. The busi-

ness is now operated as Fletcher Aviation Division of plaintiff. Its principal business was and is the manufacture and sale of external fuel tanks for military aircraft of the United States. Fletcher also manufactures and sells an in-flight refueling system for military jet aircraft.

73. One of the principal reasons for acquiring Fletcher Aviation was to strengthen plaintiff's asset position. Plaintiff's management was particularly interested in certain real estate owned by Fletcher Aviation.

74. The question of whether to permanently abandon mining at Juneau was discussed at various times after 1956 by the directors and officers of plaintiff company but they never considered abandoning the mine as a piece of real estate.

75. After the general manager's (Williams) report in 1948 that the mine could not operate at a profit, the conditions at the mine, both economically and physically, became worse as time progressed. Both the mining experts on the new board (Bradley and Crockett) would have recommended against reopening the mine anytime after 1948, and by 1952 it was their opinion that the mine had no significant value. The appraisals of the General Appraisal Company and the engineer consultant Hanson, and the opinions of mining engineers Bradley and Crockett confirmed Ver Halen's opinion that mining at Juneau could not be made profitable in the foreseeable future; that the investment at

Juneau had no significant value as mining property under conditions as they existed in 1958; and that plaintiff should not expend money in anticipation of possible future use of the property for mining purposes. By late 1958 after the acquisition of Fletcher Aviation and Reynolds Manufacturing Company, plaintiff's management believed it had sufficient assets to prevent the loss of its stock exchange listing if the mining assets were removed from the financial statements or were substantially written down in value. Also, for the first time since 1944 plaintiff was making a net profit and had enough income it could offset in claiming a deduction for the abandonment. In late 1958, Ver Halen recommended to the board that the company abandon its investment in the underground workings of the Juneau Mine and remove such investment from the financial statement.

76. At a meeting of plaintiff's board of directors on December 16, 1958, resolutions were adopted stating that the investments in Mine Development Costs and Preparatory Mining Costs at Juneau, Alaska, were worthless, and the officers were directed to abandon these investments. In plaintiff's books and records, an entry was made as of December 31, 1958, charging off the amounts carried as Mine Development Costs and Preparatory Mining Costs.

77. Following the adoption of the abandonment resolution, Ver Halen by telephone instructed the general manager at Juneau to stop maintaining the mine.

78. After the shutdown of the mine in 1944, plaintiff maintained an account denominated as "Mine Shutdown Expenses" showing a cost distribution as follows:

Year	Mine expense	Total mine and mill shutdown not including power costs[1]	Excess power costs not charged to sales	Grand total
1944	$19,344.05	(2)	(2)	$121,455.55
1945	28,021.10	(2)	(2)	148,557.48
1946	24,169.77	(2)	(2)	134,764.96
1947	20,759.27	(2)	(2)	105,762.93
1948	18,043.84	(2)	(2)	92,261.55
1949	6,532.27	$22,513.39	$53,550.41	76,063.80
1950	6,103.75	19,645.81	55,638.95	75,284.76
1951	2,394.18	20,392.24	53,386.93	73,779.17
1952	1,782.95	22,987.56	73,170.58	96,158.14
1953	805.97	20,491.24	47,060.45	67,551.69
1954	1,478.55	19,139.59	54,560.46	73,700.05
1955	1,260.84	17,679.07	41,238.30	58,917.37
1956	1,777.40	20,365.45	35,497.58	55,863.03
1957	(2)	(2)	(2)	31,458.65
1958	(2)	(2)	(2)	23,239.71
				$1,234,818.84

[1]This column includes mine expenses plus other shutdown maintenance costs.

[2]No separate breakdown for these years.

After 1958 the excess power costs were not included in the mine shutdown account but were just charged off. Plaintiff still maintains this account to cover expenditures for safety purposes, but after 1959, the amounts were no longer segregated in the tax returns because they were so small.

79. By letter dated May 26, 1958, plaintiff's general manager wrote the Board of Equalization of the city of

Juneau that the land, mining mill, and mining machinery and equipment it owned at Juneau were practically worthless, and requested the tax assessment be reduced to a nominal value. The real property was not assessed for tax purposes prior to 1958. For 1958 and subsequent years, plaintiff has paid the taxes assessed against it by the city of Juneau, the Greater Juneau Borough, and/or the Juneau Douglas Independent School District on the land which overlies its mine and mining claim.

80. Plaintiff's annual report to its stockholders for the year ended December 31, 1958 (published after March 24, 1959), contained a note to the financial statement that the directors had arranged for a determination as to the feasibility of future possible economic operations of the Juneau mining properties and appraisals of the fair values of such properties; that the reports indicated that such assets were carried at amounts greatly in excess of their values; that in December of 1958, the company's board of directors determined that the portion of its investment in mining properties represented by Mine Development Costs and Preparatory Mining Costs (carried at $4,088,877) were worthless, and directed that they be abandoned; and that the carrying values of these items were written off as of December 31, 1958, by a charge to earned surplus.

81. The proxy statement of plaintiff's management, concerning a special meeting of stockholders to be held June 24, 1959, reported on a proposed quasi-reorganization of the company. It was reported that the Juneau assets had been appraised and were overvalued on plaintiff's books; that as of December 31, 1958, Mine Development Costs, Preparatory Mining Costs and prop-

erty carrying charges totaling $4,088,877 were written off; and that management proposed to complete the restatement of the mining properties by reducing the carrying value of its investment in the Juneau properties by $10,434,354 at March 31, 1959.

82. Outside of the 1958 annual report and the proxy solicitations statement for the June 24, 1959 directors meeting, plaintiff made no other report or announcement that it had abandoned the Juneau mine or mining in that area with the exception of two prospectuses filed by the company in 1962 and 1964 wherein it stated that

> The company does not expect to be able to resume profitable mining activity at these locations,

and

> the mill buildings are unoccupied, in fair shutdown condition and of little value except for mining operations (which are not contemplated by the Company).

83. In accordance with a resolution of the board of directors adopted March 24, 1959, ratified by the stockholders on June 24, 1959, plaintiff readjusted the value of its mining properties on its books as of March 31, 1959, to reflect their then estimated fair market value. This reevaluation of mining assets was made by reducing the assets of the corporation on its books by $11,130,936 and eliminating the deficit in plaintiff's earned surplus on its books in the amount of $5,475,260, and at the same time reducing its capital surplus in the amount of $16,606,196. The completion of this "quasi-reorganization" was reported in a financial statement for the 3-month period ended March 31, 1959.

84. On June 25, 1959, plaintiff's corporate name was changed from the Alaska Juneau Gold Mining Company to A. J. Industries, to more fully indicate the nature of the company. Plaintiff had begun to acquire industrials and was no longer active in mining.

85. It was estimated by three mining engineers who testified for plaintiff as expert witnesses that by 1958 the cost of labor and supplies had increased approximately three to four times over what it was in the early 1940's. Based upon this estimate, it would require a corresponding increase in the price of gold from $35 per ounce to between $105 and $120 per ounce to consider the Juneau mine as being a potentially profitable operation again. Plaintiff's experts believed that it was unlikely there would ever be such a large increase, or if it did occur, it would be so distant that it would not be worth waiting for.

86. Even if the price of gold had increased commensurate with the increase in costs since the early 1940's, by 1958 and for a number of years prior thereto there were other problems which had to be overcome before the Juneau mine could be reopened. The mine, mill, wharf, powerplants and other items of equipment needed for the operation of the mine would have required heavy alteration, repair and rehabilitation if the mine were to be reopened. Although some of the equipment could have been used again, most of it would have had to be replaced. A skilled crew and foreman would have been difficult, if not impossible, to obtain. By 1958 the key men plaintiff had originally retained were either gone or too old. Operating with an inexperienced crew would greatly increase the cost of production for a substantial period of time. For these rea-

sons and others, it was estimated that the capital expenditure required to reopen the mine in 1958 would have been from two to three million dollars. For the same reasons, the cost and difficulties of reopening the mine in 1950, 1952, or 1956, would not have been much less.

87. In view of the comparatively higher costs in Alaska and the low grade of the ore, an increase in the price of gold would be more likely to bring about a reactivation of gold mines in other parts of the country, such as California, before the Alaska mines could be reopened. Plaintiff had two subsidiaries which owned mines in California with ore that was estimated to be three or four times the value of the Juneau ore.

88. In 1960, plaintiff informed the Department of Taxation for the State of Alaska that it "received no income from any mining activities in Alaska in 1959 and anticipates engagin[sic] in no such activities there in the foreseeable future." For the years 1960-1962 and 1965 plaintiff obtained an annual mining license from the State of Alaska, and in its application for 1962 plaintiffs requested a license to "prosecute the business of lode mining [of] gold." For the calendar years 1959-1964, plaintiff filed an Alaska License Tax on mines and mining returns on which it indicated that there was no operation and that no income was earned. The purpose in obtaining the mining licenses was to permit plaintiff to continue selling to the Government the gold dust it recovered during its program of cleanup of the mill and dismantling of equipment.

89. In October 1958, plaintiff formed a Mexican subsidiary, Cia. Minera de Guazapares, S.A. de C.V. for the purpose of exploring certain mining proper-

ties in the State of Chihuahua, Mexico. Plaintiff now owns 49 percent of the Mexican company, with Mexicans owning a majority. The company operates a gold and silver mine.

90. In November 1959, plaintiff purchased all of the stock of Druwhit Metal Products Co., manufacturers of aluminum and steel window sash and aluminum curtain wall, for a purchase price of $133,554, payable $25,000 on the date of purchase and the balance payable in annual installments of $12,500. The reason for this acquisition was that Fletcher Aviation had entered the curtain wall business but lacked sufficient years of experience in the field to bid on certain state and Federal buildings. Accordingly, in order to be able to participate in these larger markets, plaintiff purchased Druwhit, which was qualified to make such bids, and then merged the curtain wall department of Fletcher into Druwhit.

91. In late 1959 and January of 1960, plaintiff began to acquire large acreages of real property for development and sale under the direction of A. J. Land Company, a division of plaintiff. The property involved included 550 acres in the Oceanside, California, area, acquired through land contracts, 170 commercial acres surrounding the Fletcher Aviation plant, acquired in the Fletcher acquisition, and the surface rights of the Juneau real estate in speculation that its value will increase from anticipated growth and development of the city of Juneau.

92. In July 1960, plaintiff purchased certain assets of B & N Manufacturing Co., Inc., an Indiana trailer door manufacturer for $404,791. Plaintiff has paid $254,791 in cash and issued $150,000 in plaintiff's

stock (29,268 shares) to the seller. This business is now operated by B & N Mobile Home Door, Inc., a wholly owned subisidiary of the plaintiff. This acquisition was a continuation of plaintiff's policy of diversification by absorbing companies that plaintiff's management believed would operate profitably within their financial structure.

93. In August 1960, and subsequently, plaintiff acquired approximately 99 percent of the stock of Lansing Company through an exchange of plaintiff's own shares with the Lansing stockholders. To date, plaintiff has issued a total of 158,506 shares of its stock and paid $15,036 in exchange for 113,053 shares of Lansing Company stock. Lansing is a Michigan manufacturer of material handling equipment, wheelbarrows, and hand trucks.

94. Plaintiff learned that B & N Manufacturing Co., Inc., and Lansing Company were for sale through commission agents who were in the business of seeking such companies out and presenting them to companies like plaintiff which had acquired a reputation in the trade of being an acquisition company.

95. In August 1960, plaintiff purchased for a price not to exceed $350,000, all of the stock of Jessup Woods Products, Inc., a Michigan corporation. Thereafter, the business and assets of Jessup were transferred to plaintiff and it has since been operated as a division of the plaintiff. As of September 14, 1962, plaintiff had paid $100,000 in cash and issued $100,000 of its stock (25,000 shares) to the seller on account of the purchase price. Jessup was, and is engaged in the manufacture and distribution of louvered doors, louvered blinds and shutters, and all types of doors.

96. Beginning in December 1960, plaintiff acquired 100 percent of the outstanding capital stock of Roberts-Gordon Appliance Corporation (New York) and Roberts-Gordon Appliance Corporation Limited (Canada), manufacturers of oil and gas burners, boilers, water hearts, infra-red heaters and furnaces. The total acqusition cost of such stock was $1,200,380 payable in shares of plaintiff's capital stock. These companies also were presented to plaintiff by a business broker.

97. In September 1961, plaintiff acquired 100 percent of the capital stock of the Sargent Engineering Corporation and Sargent Rodless Pump Company at a price of $1,103,360 in cash and 311,540 shares of plaintiff's capital stock (valued at $1,325,045 or $4.25 per share, the market value in mid-February 1961, the date of commencement of negotiations). Since October 1, 1961, the Sargent Engineering Corporation and Sargent Rodless Pump Company have been operated as subsidiaries of the plaintiff. The Sargent Engineering Corporation manufactures and sells hydraulic and pneumatic products consisting of valves, gears, etc., and also manufactures and sells oil well pumping equipment. The activities of Sargent Rodless Pump Company are limited to the holding and exploitation of patents on a deep well pump and various improvements thereto.

98. Plaintiff's management had known of the Sargent companies for a number of years. The vice president of Sargent Engineering, Edward J. Sargent, has been a member of plaintiff's board of directors since 1956. The companies also had common auditors. Plaintiff's management believed the Sargent companies had some affinity to plaintiff inasmuch as they were in a defense field as was Fletcher Aviation.

99. It is plaintiff's general policy that each of its divisions specializes in its chosen industrial field. However, plaintiff tried to get the divisions so acquainted with each other that there is allied use of equipment or functions. Where they can be buyers from each other of part of their needed supplies, they do so. The acquisitions were made on the basis that each company had to stand on its own industry and have potential of being expanded and made a larger entity in its chosen field under the umbrella of being an A. J. division.

100. Except in the cases of Sargent Engineering, Sargent Rodless Pump, and the Lansing Company, no member of plaintiff's board of directors had any interest in any of the aforementioned acquired companies prior to the acquisition. In the case of the Sargent Company, Edward J. Sargent, a member of plaintiff's board of directors and a member of the original Stockholders Action Committee, and his family owned 100 percent of the Sargent companies. In the case of the Lansing acquisition, Mr. Ver Halen was a director and president of Lansing Company.

101. At the end of plaintiff's taxable years 1957 through 1961, plaintiff's 10 largest stockholders did not own 50 percentage points more of the fair market value of plaintiff's outstanding stock than such persons owned at the beginning of such taxable years.

102. There was no substantial change in the stock ownership of plaintiff during the years 1957 through 1961, other than the normal changes to be expected in a publicly held stock which was listed and traded on the New York Stock Exchange.

103. For the year 1932, the taxpayer claimed on its Federal tax return amortization on the Mine Develop-

ment Cost Account, based on an estimated total tonnage of 150 million tons. This amortization was disallowed as it was determined that this account was subject to the percentage depletion deduction elected by the taxpayer rather than amortization after 1932. The taxpayer accepted this determination of the Revenue Service.

104. Plaintiff estimated that the amortization of its capitalized development costs would be based on a total tonnage of 50 million as of January 1914. During the years 1915 to 1926, plaintiff computed additions to this total to be 100 million tons, so that by 1926 its basis for amortization, prior to annual extinguishment totaled 150 million tons. This 150 million ton estimate did not include a 10 million ton estimate as of 1932, added when plaintiff commenced mining in a portion of the mine known as the "Deep North," nor an additional 30 million ton estimate as of 1934, when plaintiff acquired other parts, known as the "Icy Gulch" and "Perseverence" parts of the mine. The Internal Revenue Service accepted plaintiff's computation in computing the allowable amortization of the capitalized development account through 1929. In addition, pursuant to plaintiff's own estimates, the Internal Revenue Service allowed cost depletion from 1916 through 1931 on an estimated total of 150 million tons.

ULTIMATE FINDINGS OF FACT

105. Plaintiff's Juneau, Alaska, gold mine became worthless and was a loss as a gold mine prior to 1958.

106. Plaintiff's investment in the capitalized development costs of the underground workings of the Juneau mine were potentially valuable assets for only as

long as they were reasonable prospects of a sufficient increase in the price of gold.

107. By 1956 the prospects for an increase in the price of gold to the extent necessary for plaintiff to operate its mine at a profit were extremely remote.

108. By 1957 plaintiff's management had realized that its mine was noneconomic and the prospects of its ever being reopened were remote.

109. By 1957 plaintiff's mine and related equipment had deteriorated to such a condition, that even with an increase in the price of gold, the mine was inoperable.

110. By 1957 plaintiff had no reasonable prospects for potential operation of its Juneau mine.

CONCLUSION OF LAW

Upon the foregoing findings of fact and opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

APPENDIX B.

The relevant provisions of the Internal Revenue Code of 1954 (26 U.S.C.) are as follows:

Section 165. LOSSES.

(a) GENERAL RULE.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

. . . . .

Section 1311. CORRECTION OF ERROR.

(a) GENERAL RULE.—If a determination (as defined in Section 1313) is described in one or more of the paragraphs of Section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of Section 1312 is prevented by the operation of any law or rule of law, other than this part and other than Section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in Section 1314.

(b) CONDITIONS NECESSARY FOR ADJUSTMENT.—

. . . . .

(2) CORRECTION NOT BARRED AT TIME OF ERRONEOUS ACTION.—

. . . . .

(B) DETERMINATION DESCRIBED IN SECTION 1312(4).—In the case of a determination described in section 1312(4) (relating to disallowance of certain deductions and credits), adjustment shall be made under this part only if credit or refund of the overpayment attributable to the deduction or credit de-

scribed in such section which should have been allowed to the taxpayer or related taxpayer was not barred, by any law or rule of law, at the time the taxpayer first maintained before the Secretary or his delegate or before the Tax Court of the United States, in writing, that he was entitled to such deduction or credit for the taxable year to which the determination relates.

. . . . .

Section 1312. CIRCUMSTANCES OF ADJUSTMENT.

The circumstances under which the adjustment provided in Section 1311 is authorized are as follows:

. . . . .

(4) DOUBLE DISALLOWANCE OF A DEDUCTION OR CREDIT.—The determination disallows a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another taxable year, or to a related taxpayer.

. . . . .

Section 1313. DEFINITIONS.

(a) DETERMINATIONS.—for purpose of this part, the term "determination" means—

(1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final;

. . . . .

Section 1314. AMOUNT AND METHOD OF ADJUSTMENT.

(a) ASCERTAINMENT OF AMOUNT OF ADJUSTMENT.—In computing the amount of an adjustment under this part there shall first be ascertained

the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be the excess of—

(1) the sum of—

(A) the amount shown as the tax by the taxpayer on his return (determined as provided in section 6211 (b) (1), (3), and (4), relating to the definition of deficiency), if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in section 6211 (b) (2), made.

There shall then be ascertained the increase or decrease in tax previously determined which results solely from the correct treatment of the item which was the subject of the error (with due regard given to the effect of the item in the computation of gross income, taxable income, and other matters under this subtitle). A similar computation shall be made for any other taxable year affected, or treated as affected, by a net operating loss deduction (as defined in section 172) or by a capital loss carryover (as defined in section 121) determined with reference to the taxable year with respect to which the error was made. The amount so ascertained (together with any amounts wrongfully collected as additions to the tax or interest, as a result of such error) for each taxable year shall be the amount of the adjustment for that taxable year.

(b) METHOD OF ADJUSTMENT.—The adjustment authorized in section 1311 (a) shall be made by as-

sessing and collecting, or refunding or crediting, the amount thereof in the same manner as if it were a deficiency determined by the Secretary or his delegate with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year or years with respect to which an amount is ascertained under subsection (a), and as if on the date of the determination one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year or years. If, as a result of a determination described in section 1313(a)(4), an adjustment has been made by the assessment and collection of a deficiency or the refund or credit of an overpayment, and subsequently such determination is altered or revoked, the amount of the adjustment ascertained under subsection (a) of this section shall be redetermined on the basis of such alteration or revocation and any overpayment or deficiency resulting from such redetermination shall be refunded or credited, or assessed and collected, as the case may be, as an adjustment under this part. In the case of an adjustment resulting from an increase or decrease in a net operating loss which is carried back to the year of adjustment, interest shall not be collected or paid for any period prior to the close of the taxable year in which the net operating loss arises.

(c) ADJUSTMENT UNAFFECTED BY OTHER ITEMS.—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this part, shall not be diminished by any credit or set-off based upon any item other than the one which was

the subject of the adjustment. The amount of the adjustment under this part, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item other than the one which was the subject of the adjustment.

. . . . .

The relevant provisions of the Treasury Regulations are as follows:

Treas. Reg. 118, Sec. 39.23(1)-3. LOSS OF USEFUL VALUE.—

(a) When, through some change in business conditions, the usefulness in the business of some or all of the assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis [adjusted] and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as the result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radi-

cally different use, and to machinery only when its use as such is permanently abandoned.

. . . . .

Treas. Reg. Sec. 1.165-2. OBSOLESENCE OF NON-DEPRECIABLE PROPERTY.—

(a) ALLOWANCE OF DEDUCTION. A loss incurred in a business or in a transaction entered into for profit and arising from the sudden termination of the usefulness in such business or transaction of any non-depreciable property, in a case where such business or transaction is discontinued or where such property is permanently discarded from use therein, shall be allowed as a deduction under Section 165(a) for the taxable year in which the loss is actually sustained. For this purpose, the taxable year in which the loss is sustained is not necessarily the taxable year in which the overt act of abandonment, or the loss of title to the property occurs.

. . . . .

Treas. Reg. Sec. 1.1312-4. DOUBLE DISALLOWANCE OF DEDUCTION OR CREDIT.—

(a) Paragraph (4) of section 1312 applies if the determination disallows a deduction or credit which should have been, but was not, allowed to the same taxpayer for another taxable year or to a related taxpayer for the same or another taxable year. This is one of the two circumstances in which the maintenance of an inconsistent position is not a requirement for an adjustment but the requirements in Paragraph (b) of §1.-1311(b)-2 must be fulfilled (correction not barred at time of erroneous action).

(b) The application of paragraph (a) of this section may be illustrated by the following examples:

Example (1). The taxpayer, A, who computes his income by use of the accrual method of accounting, deducted in his return for the taxable year 1951 an item of expense which he paid in such year. At the time A filed his return for 1951, the statute of limitations for 1950 had not expired. Subsequently, the Commissioner asserted a deficiency for 1951 based on the position that the liability for such expense should have been accrued for the taxable year 1950. In 1955, after the period of limitations on refunds for 1950 had expired, there was a determination by the Tax Court disallowing such deduction for the taxable year 1951. A is entitled to an adjustment for the taxable year 1950. However, if such liability should have been accrued for the taxable year 1946 instead of 1950, A would not be entitled to an adjustment if a credit or refund with respect to 1946 was already barred when he deducted such expense for the taxable year 1951.

. . . . .

LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
JUN 26 1968
JOHN F. DAVIS, CLERK

No. 183

In the Supreme Court of the United States

OCTOBER TERM, 1968

A. J. INDUSTRIES, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ERWIN N. GRISWOLD,
Solicitor General,

MITCHELL ROGOVIN,
Assistant Attorney General,

ROBERT N. ANDERSON,
KARL SCHMEIDLER,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 183

A. J. INDUSTRIES, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The question in this case is whether 1958 was the correct year for petitioner to claim an abandonment loss deduction under Section 165(a) of the Internal Revenue Code of 1954 with respect to the underground workings of its Alaska Juneau Gold Mine at Juneau, Alaska.

Petitioner operated the mine from 1897 until 1944. From 1928 until 1942 its operations were highly profitable, and the company declared and paid dividends in excess of $14 million. However, in 1944, after two

successive years of operating losses the mine was shut down. (Pet. App. 6-8, 22.)

Believing that after the war economic conditions would improve, petitioner maintained the mine on a standby condition for eventual reopening. In 1948, in considering whether to use its Juneau assets for other ventures, it was informed that the price of gold would have to be increased to $60 per ounce in order to mine again. After 1948, the economic conditions for gold mining steadily worsened so that by 1958 the gold price would have had to be increased to between $105 and $120 per ounce to justify consideration of reopening the mine. After 1948, petitioner expended substantially less and less funds on maintaining its mine in a standby condition. By 1954 only two of its experienced key men remained in petitioner's employ; its machinery and equipment were becoming worn and obsolete; natural deterioration of the mine increased; and drifts and cave-ins were not corrected because the dwindling personnel could no longer keep up with the increased work. The lower levels of the mine were flooded, not only for preservative measures, but also because the pumping equipment had to be, but was not, replaced. By 1953, it appeared that reopening of the mine was highly unlikely, so petitioner began looking for new businesses. (Pet. App. 22.)

By 1956, petitioner's stockholders were dissatisfied with the policies of the management and elected a new slate of directors who promised "to face up to the fact that there is no prospect of mining gold at a profit from our present properties in the foreseeable future." After Mr. Ver Halen, the leader of the in-

surgent group, had returned from his inspection of the Juneau mine, he realized the mine was inoperable, uneconomic, and unlikely to be operated in the foreseeable future. He recommended that the board immediately begin its acquisition of new businesses. The two mining engineers on the new board expressed their opinion that the mine was noneconomic. The Juneau banks refused to loan even $50,000 on the mining assets. (Pet. App. 23.)

In 1957 the General Appraisal Company told petitioner that the patented lands, mine improvements, mill and ore bodies were of no present economic value. The 1958 report of Wilbur H. Hanson, whom petitioner had hired as an engineer consultant, gave the same opinion. (Pet. App. 14, 23.) In December 1958 petitioner's Board of Directors resolved to abandon the underground workings of the mine as worthless, and the assets were written off as of December 31, 1958.

Petitioner claimed an abandonment loss deduction of over $2,000,000 in its 1958 tax return and a carryback to 1957 and a carryforward to 1959, 1960 and 1961 of the resulting operating loss. The Commissioner of Internal Revenue disallowed the deduction and assessed deficiencies for 1957, 1958 and 1959. Petitioner paid the amounts and brought the present suit for refund. The Court of Claims held that petitioner's Juneau mine became worthless prior to 1958, and dismissed the suit. (Pet. App. 24.)

The decision below is correct. There is no conflict or any other warrant for review by this Court.

1. Section 165(a) of the Internal Revenue Code of 1954 permits the deduction of "any loss sustained during the taxable year and not compensated for by insurance or otherwise." As this Court held in *Boehm* v. *Commissioner*, 326 U.S. 287, 291, in referring to the 1936 precursor of Section 165(a) and the long standing Treasury Regulations on the subject—"deductible losses 'must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed.'" See, also, 5 Mertens, *Law of Federal Income Taxation* (Rev.), Sec. 28.04, p. 10.

These general rules apply to losses sustained upon the abandonment of property. As the Court of Claims correctly pointed out (Pet. App. 4-5): "Whether the property actually did lose its useful value in a particular year, and whether the owner actually did abandon it as an asset during that year, are questions of fact to be determined from a consideration of all the surrounding facts and circumstances. * * * The determination as to the year an asset loses its useful value or becomes worthless is a matter of sound business judgment, and that judgment should be given effect unless it appears from the facts that the decision as to the year of loss was unreasonable or unfair at the time the decision was made. Thus, the test is whether the plaintiff has established that under all the facts and circumstances and in the exercise of reasonable business prudence, it fairly determined that its investment in its mine was lost and should be abandoned as worthless in 1958." See, *e.g.*, *Boehm* v. *Commissioner*, *supra*, pp. 292, 293-294; *James*

Petroleum Corp. v. *Commissioner*, 238 F. 2d 678, 680 (C.A. 2); *Mine Hill and Schuylkill Haven R. Co.* v. *Smith*, 184 F. 2d 422 (C.A. 3), certiorari denied, 340 U.S. 932; *Superior Coal Co.* v. *Commissioner*, 145 F. 2d 597, 599 (C.A. 7), certiorari denied, 324 U.S. 864; *Burke* v. *Commissioner*, 283 F. 2d 487, 488-489 (C.A. 9).[1]

Petitioner does not disagree with the court's findings as to what occurred, but contends (Pet. 7-11) that its own subjective belief as to when the mine became worthless should be the controlling or sole criterion in resolving this case. Such a contention was expressly rejected by this Court in *Boehm* v. *Commissioner*, *supra*, pp. 292-293. See, also, *James Petroleum Corp.* v. *Commissioner*, *supra*, p. 680; *Superior Coal Co.* v. *Commissioner*, *supra*; *Mine Hill & Schuyl-*

---

[1] The test applied here is identical with the rule of the cases on which petitioner relies, at pp. 7-8 of the petition. Its argument, for which there is no legal precedent, is that the loss deduction may be postponed until the taxpayer, by formal corporate declaration, declares the property abandoned. A taxpayer does not have such discretion to choose the year for which to obtain the tax benefits of the deduction. See *James Petroleum Corp.* v. *Commissioner*, *supra*, p. 680. As the Court of Claims found (Pet. App. 23-24):

> plaintiff's prolonged overstatement of the value of its assets to meet its stock exchange problem, coupled with the obvious tax advantages which accrued, explain eloquently the delay to 1958 in the write-off of the Juneau mine investments. It cannot be ignored that the resolution of plaintiff's board of directors (upon which plaintiff bases its abandonment) was not passed until December 16, 1958, near the end of the first taxable year in which plaintiff made a net operating profit after 14 successive years of net operating loss.

kill Haven R. Co. v. *Smith, supra,* pp. 426-427. It is in all events clear that the insurgents, at the time of their 1956 takeover, had formed the judgment that the property was already valueless.

2. Petitioner's reliance (Pet. 13) upon *Pearl Assurance Co.* v. *United States,* 324 F. 2d 512 (Ct. Cl.), and *Harlan* v. *United States,* 312 F. 2d 402 (Ct. Cl.), is misplaced. In those cases the Commissioner had allowed a loss deduction in the year in which it was claimed, and the court held that the Commissioner should have allowed a carryback of the loss to other years for which refund claims had been filed, but not on grounds of carryback. In the present case, on the other hand, petitioner did not ask the Court of Claims to fix the loss in some other year, if it held that petitioner did not realize the loss in 1958. Even now petitioner only claims that the loss occurred "in either 1956 or 1957," and there is no basis for placing the loss in 1957, the only year prior to 1958 for which a refund was claimed and that was in issue below.

3. The opinion below does not support petitioner's contention (Pet. 12) that it is entitled at least to a deduction for 1956 or 1957 pursuant to the "mitigation" provisions of the 1954 Code. The argument should not be considered because it is made for the first time in this Court. If petitioner meets the complex requirements of Sections 1311(b) and 1312—a matter that was not litigated below and that is by no means as clear as petitioner suggests—the proper course is for it to initiate, for the proper year, the refund procedure required by Section 1314(b) within

one year (*ibid.*) of the day on which the present decision becomes final.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General,

MITCHELL ROGOVIN,
Assistant Attorney General,

ROBERT N. ANDERSON,
KARL SCHMEIDLER,
Attorneys.

JULY, 1968.

U. S. GOVERNMENT PRINTING OFFICE: 1968 314544 56